FILE COPY

Office-Supreme Court, U.S.
FILED
JUN 8 1959
JAMES R. BROWNING, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1958

No. [redacted] 102

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

v.

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI

WATSON WASHBURN
*Attorney for Petitioners*
36 West 44th Street
New York 36, N. Y.

# INDEX


PAGE

Petition for Writ of Certiorari:

Jurisdiction ..... 1
Opinions Below ..... 1

Summary Statement of the Case ..... 2

Statement of Facts ..... 3
Questions Presented ..... 14
Reasons Relied on for the Allowance of the Writ ..... 15

POINT I—The instant case is in conflict with the decision of this Court in *La Buy* v. *Howes Leather Co.*, 352 U. S. 249 ..... 17

POINT II—The instant case is in conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica* ..... 19

POINT III—The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western Pacific R.R. Corp.* v. *Western Pacific R. R. Co.* ..... 25

POINT IV—The decision below is in conflict with the decisions of the Court of Appeals for the Tenth and Second Circuits and for the District of Columbia in *Durnett* v. *Auer*, *Hughes* v. *Securities & Exchange Comm.*, and *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.* ..... 28

PAGE

POINT V—The decision below is in direct conflict with an important provision of the plan of reorganization of the Alton Railroad Company, which became final on May 31, 1947, after approval by the Interstate Commerce Commission and the Federal District Court having jurisdiction ..... 30

POINT VI—The decision below is in conflict with the unmistakable trend of the decisions of all the Federal Courts in this century ..... 32

Conclusion ..... 51

## TABLE OF CASES CITED

*Bawden* v. *Midland Steel Co.*, 254 Ill. 464 ..... 28

*Chicago, Burlington & Quincy R. Co.* v. *Boyd*, 118 Ill. 73 ..... 30

*Durnett* v. *Auer*, 71 F. 2d 912 ..... 28

*Gratz* v. *Claughton* (C. A. 2), 187 F. 2d 46, cert. denied 341, U. S. 920 ..... 35, 36, 37

*Hooker* v. *Midland Steel Co.*, 215 Ill. 444 ..... 28

*Huck* v. *Chicago & Alton R. Co.*, 86 Ill. 350 ..... 30

*Hughes* v. *Securities & Exchange Comm.* (C. A. 2), 139 F. 2d 434 ..... 28, 29

*Joliet & Chicago R. R. Co.* v. *United States* (1941), 118 F. 2d 174 ..... 30

*La Buy* v. *Howes Leather Co.*, 352 U. S. 249 ..... 15, 17, 18

PAGE

*Mansfield Hardwood Lumber Co.* v. *Johnson*, 263 F. 2d 748 ..... 28

*Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.* (D. C. App.), 177 F. 2d 228 ..28, 29

*Pearlman* v. *Feldmann* (C. A. 2), 219 F. 173 ..... 39

*South Western R. Co.* v. *Benton*, 206 Ga. 770 ..... 43

*Speed* v. *Transamerica Corp.*, C. A. 3, 235 F. 2d 369, affirming 99 F. S. 820 ..... 15, 19, 20, 21, 22, 23, 24

*Strong* v. *Repide*, 213 U. S. 419 ..... 28

*Union Mutual Life Ins. Co.* v. *Frear Stone Mfg. Co.*, 97 Ill. 537 ..... 26

*United States* v. *Cumberland Public Service Co.*, 338 U. S. 451 ..... 11, 49

*United States* v. *Gypsum Co.*, 333 U. S. 364 ..... 3

*United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44 ..... 39

*Western Pacific R. R. Corp.* v. *Western Pacific R. R. Co.*, 206 F. 2d 495, cert. denied 346 U. S. 910 ..... 15, 16, 25

*Zahn* v. *Transamerica Corp.* (C. A. 3), 162 F. 2d 36 ..... 29

## Other Authorities Cited


| | PAGE |
|---|---|
| 58 Col. Law Rev. 452, 455-459 | 18 |
| Commerce Clearing House, Standard Federal tax reports No. 5, January 11, 1950 | 11 |
| Federal Securities Exchange Act of 1934 | 2, 29 |
| Illinois Private Laws 1861, p. 497 | 4 |
| Illinois Statutes 1855, pp. 263 *et seq.* | 4 |
| Prentice-Hall, weekly Federal Tax Report Bulletin, January 12, 1950 | 11 |
| Professor Loss, Securities Regulations (1951 ed. p. 835) | 19 |
| Securities Exchange Commission Rules: | |
| Rule X-1013-5 | 2 |
| Rule X-10 B-5 | 20, 29 |
| "Taxes, the Tax Magazine", February, 1950, p. 104 | 11 |
| 28 U. S. C. 1254 (1) | 1 |

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1958**

**No.**

---

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

v.

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

---

## PETITION FOR WRIT OF CERTIORARI

*To the Honorable The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:*

Petitioners respectfully pray that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Seventh Circuit to review the judgment of that court rendered in the above cause, affirming the judgment and decree of the United States District Court for the Northern District of Illinois, Eastern Division.

### Jurisdiction

Jurisdiction of this Court is invoked under the United States Code, Title 28, Section 1254(1). The date of the order and judgment of the Seventh Circuit Court of Appeals was March 9, 1959.

## Opinions Below

The district court affirmed without opinion the report of the special master, which is set forth in the printed copy of the record filed herewith (A. 4-153[1]). The opinion of the court below, which is also set forth therein (following A. 173), is reported in 264 F. 2d 445.

## Summary Statement of the Case

This suit was brought by a number of former minority stockholders of the Joliet & Chicago Railroad Company (hereinafter called Joliet) against the defendant (hereinafter called Gulf), formerly majority and controlling stockholder, for equitable relief and damages based on defendant's stoppage of its guaranteed dividend payments on Joliet stock and its failure when buying plaintiffs' stock to disclose material facts affecting its value to the plaintiffs, in violation of its fiduciary obligations, by which unfair conduct it was enabled to reap large profits at the plaintiffs' expense. The complaint alleges two causes of action; the first relies upon diversity of citizenship, and the second on the Federal Securities Exchange Act of 1934 and Rule X-10B-5 of the S. E. C. made pursuant thereto.

Over plaintiffs' objections in open court, the District Judge referred the case, on the basis of defendant's representation that it would take at least a week to try. The special master heard the case in two days, and recommended a decree for the defendant. The District Court confirmed his report in every respect,

[1] Refers to pages of Plaintiffs' Appendix.

and entered judgment for the defendant. The Court of Appeals affirmed.

## Statement of Facts

There is remarkably little in the record which is disputed. Plaintiffs rely almost entirely on the defendant's own admissions in examinations before trial, on its own contemporary records and actions, and on other contemporary documents, which were uncontradicted.

The Master and the District Court found that "there was no conflict in the evidence except on the issue of the fair value of Joliet shares in 1950." (Sum. 56, A. 30). The Court of Appeals found the evidence was "not free from conflict," but furnished "ample support for the findings made by the special Master." It made no mention of the rule that where all the evidence is in documents or depositions, an appellate court may form its own opinion without regard to interpretations of the trial tribunal. *United States* v. *Gypsum Co.*, 333 U. S. 364, 395.

---

Plaintiffs were the holders of an aggregate of 4,310 shares of Joliet capital stock prior to February 14, 1950; of these shares 100 were acquired by plaintiff Norwich Free Academy in 1877, 1350 by Blackstone Memorial Library before 1903, and the remainder by the other plaintiffs in 1947, 1948 and 1949. On February 14, 1950 these shares were purchased from them by the defendant through its wholly-owned subsidiary, Gulf, Mobile & Ohio Land Company. The defendant

then, and for a little more than two years prior thereto, had been the majority stockholder of Joliet, and all the officers and directors of Joliet were officials or employees of Gulf. (Findings 24, 28, 31,[1] A. 122, 123, 124, 125, 131.)

The property of Joliet had been leased in perpetuity to Gulf and its predecessors in interest for nearly one hundred years. The rental consisted of payment of $7.00 dividends per share annually to the lessor's stockholders, the lessee being bound to pay all taxes assessed on account of said dividends. Joliet was chartered in 1855 (Ill. Stat. 1855, pp. 263 *et seq.*), and its existence was made perpetual in 1861. (Ill. Private Laws 1861, p. 497.)[2] An amendment made in 1939 provided that no dividends were payable on stock registered in the lessee's name. (Findings 7-12, A. 118-120.)

Gulf acquired the lease, together with the other assets of the Alton Railroad Company, under a Plan of reorganization which was approved by the Interstate Commerce Commission in 1945, and finally consummated by decree of the Federal District Court in Chicago on May 31, 1947. (Findings 14, 16, A. 120-121.) The assumption agreement provided that the lease should be deemed a lease and not a conveyance in fee. Gulf reserved the right to litigate its liability to pay the Federal corporate income tax of the Joliet

[1] Refers to the numbered Findings of Fact in the Master's Report. (A. 118-147.)

[2] This antedated both the Illinois Constitution and the Revised Statutes, so that to dissolve Joliet certainly, and to transfer a substantial part of its assets outside the usual course of business probably, required the unanimous consent of its stockholders.

Company. At some time during this period, Gulf determined to acquire, if possible, all the stock of Joliet. (Finding 17, A. 121.)

Gulf did not pay Joliet's 1946 tax due March 15, 1947. (Finding 20, A. 122.) Federal income tax authorities filed a lien upon Joliet on January 27, 1948 and thereafter Gulf paid the Joliet dividends to the United States Treasury Department in partial satisfaction of the lien, and all payments of dividends to Joliet stockholders ceased. (Finding 35, A. 125-126.) Meantime, in the early fall of 1947, Gulf secured the *ex parte* approval of the Interstate Commerce Commission to an offer of $150. par value of its 4% bonds in exchange for each share of Joliet stock. (Finding 18, A. 121-122.)

In connection with this exchange offer, Gulf stated that if substantially all of the stock was not exchanged, it would bring an action for declaratory judgment that it was not liable to pay the Federal taxes on Joliet's income. (Finding 18, A. 121-122.)

Gulf sued for such a declaratory judgment on December 24, 1947 in the Circuit Court of Cook County, announcing at about the same time that all dividends on Joliet stock would necessarily cease until this suit was finally determined. (Finding 34, A. 125.) [1] The Blackstone Memorial Library requested that Joliet retain as its attorneys in this proceeding the firms of Fallansbee, Shorey & Schupp of Chicago and Perkins, Malone & Washburn of New York, who represented

[1] The opinion below states: "for some reason not discernible * * * dividend payments were stopped." But surely the reason was obvious—to force the minority stockholders to exchange their stock.

the Joliet Company or its minority stockholders for the previous twenty-five years in various controversies with this lessee, including the question of liability for Federal taxes. Gulf declined to designate these firms or either of them, but instead left the choice of Joliet's attorneys to its own attorney, Mr. Towner, who selected a reputable Chicago lawyer who had no previous familiarity whatever with Joliet's affairs or problems. (Sum. 173, A. 64.)

Thereupon, Blackstone Memorial and the Norwich Free Academy, two of the plaintiffs who had held their Joliet stock since the last century, brought suit in the Federal District Court in Chicago against Joliet and Gulf, demanding payment of the dividends. After trial, Judge Igoe decreed in June 1949 that Gulf was liable for the taxes, and must pay the full $7.00 dividends, with interest on those in arrears. Judge Igoe announced his decision orally on April 25, 1949, citing no authorities; he merely quoted the tax covenant in the lease, consisting of five lines. (Sum. 251-253, A. 91-93.)

The Master concluded that Gulf's conduct in 1947 and 1948 was "properly criticized by Judge Igoe in his decree and findings of June 1949," when the formal decree was entered. (Conclusion[1] 124; A. 149.) Judge Igoe's findings included the following (A. 91-93):

> "On August 27, 1947, G. M. & O. filed with the Interstate Commerce Commission its application (F. D. 15834) which was heard *ex parte,* and on

[1] Refers to numbered Conclusions of Law in the Master's Report (A. 147-153).

November 24, 1947, the Commission entered an order authorizing G. M. & O. to acquire the shares of Joliet (and shares of another lessor) upon the terms and conditions set out in such order.

* * * * *

"On the date (August 27, 1947) said application was filed with the Commission, G. M. & O., by F. M. Hicks, its Executive Vice President, addressed a letter to W. L. Price, Comptroller, the Joliet and Chicago Railroad Company, Baltimore, Md., wherein it was stated that the G. M. & O. had concluded that the lease did not obligate the lessee to pay the income tax of the lessor and that accordingly, G. M. & O. did not accept liability and did not intend to pay the Federal income tax of Joliet for the year 1946 or for later years.

* * * *

"In this period, G. M. & O., in an effort to acquire shares, was advising the shareholders of Joliet of their predictment, and emphasizing the seriousness of their situation because of accumulation of back taxes and the levy and distraint instituted by the Government, the cessation of dividends, and the reduction in payments towards the tax retirement because of the acquisition and registration of shares in the name of G. M. & O.

* * * *

"The Court finds that the interest of G. M. & O. and Joliet are adverse and officers common to Joliet and G. M. & O. have not handled and managed the affairs of Joliet to the best interests of minority stockholders of the latter company."

* * * *

> "The Court concludes that G. M. & O., as majority stockholder of Joliet and as the employer of those it selected and appointed to act as directors and officers of Joliet, stands in a fiduciary position and relationship to Joliet and to the minority stockholders of Joliet and that the employees of G. M. & O., including its officers serving as directors and officers of Joliet, stand in a fiduciary relationship to Joliet and to its minority stockholders."

Gulf appealed from the decision (Finding 41, A. 127), though the possibility of Judge Igoe's decision being set aside was practically non-existent. (Finding 111, A. 146.)

When Gulf took over the operation of the former Alton properties, on May 31, 1947, included among these were some valuable land and buildings owned by Joliet, which were thereafter used in connection with certain property of Alton (hereinafter collectively called the Harrison Street properties) as a freight terminal jointly by Gulf and Baltimore & Ohio Railroad Company. B. & O. paid 70% of the costs of this operation amounting to one million three hundred thousand dollars a year. (Sum. 84, A. 37-38.) On April 7, 1949 B. & O. gave notice of cancellation to Gulf of its participation, effective October 7, 1949. (Findings 66-69, A. 132-134.)

Gulf immediately made efforts to find some other use for these Joliet and former Alton properties or some method of disposing of them advantageously, in order to avoid the loss of one million three hundred thousand dollars in revenue with which it was otherwise confronted. It was not able to make any progress

in any direction prior to November 1949; there had been no firm bid for the properties from anyone, and the highest tentative suggestion was a price of from two and a half million dollars to three million dollars. (Findings 70-74; A. 134.)

About the beginning of November, 1949, Gulf made tentative plans to employ the law firm of Arvey, Hodes & Mantynband, of Chicago, to represent Gulf in dealing with the problems arising from the projected Congress Street Super Highway, and also to assist Gulf in disposing of the Harrison Street properties to the United States Post Office Department. On November 4th Mr. Hicks saw Post Master General Donaldson in Washington, and told him that Gulf wished to sell to the Post Office Department. He discussed with Mr. Donaldson the projected Super Highway, and told him that Gulf had in mind employing Mr. Hodes of the firm of Arvey, Hodes & Mantynband and asked Mr. Donaldson if he had any objection. Mr. Donaldson said he would be pleased to have all the help either Gulf or Mr. Hodes could give him. (Findings 75, 76, A. 134-136.) On November 19, 1949, *Gulf retained* Mr. Hodes's firm by letter from its General Attorney, Mr. J. N. Ogden, approved by Mr. Hicks, to represent Gulf in the Super Highway matter and also to assist Gulf in disposing of the Harrison Street properties to the Post Office Department. The letter also mentioned possible participation of the Chicago Union Station Company, but all further negotiations were had with the United States Government alone, and these proceeded without a hitch. (Sum. 218, A. 77.) Under the agreement Gulf paid $25,000.00 down to Arvey, Hodes & Mantynband, and agreed to pay 5% of any amount

received over two and a half million dollars. (Finding 78, A. 136.) The starting point for the 5% was fixed at two and a half million because that amount was probably available elsewhere. (Sum. 185, A. 67.)

On December 1, 1949, a Committee of the Post Office Department and the General Services Administration came from Washington and went over the Gulf's property with Gulf's officials and representatives of the Hodes office. (Findings 79-82, A. 136-137.)

The official report of this group concluded with a statement that it was the opinion of the Committee that Gulf's Harrison Street properties were probably the most desirable site available for expansion of the Chicago Post Office facilities.

The Postmaster General signed his "O. K." at the end of the report on December 20, 1949, saying "Note last paragraph." The next day he attached a note to the first page of the report, stating "I agree and we should follow rec. last par." (Finding 88, A. 139.)

Early in December Mr. Hicks lunched in Chicago with Postmaster General Donaldson, Mr. Hodes and Mr. Haderlein, the Chicago Postmaster, who knew Mr. Hodes (Sum. 222, A. 79) at Mr. Hodes's club, and Mr. Hicks agreed to let the Post Office use without charge part of the Harrison Street facilities. (Sum. 214, A. 76). Mr. Hicks also at this luncheon tried to sell to the Government the idea of buying the site (Sum. 222, A. 79) though he at first denied having done so.

The purchase required the concurrence of the Government's General Services Administration. Its head,

Mr. Reynolds, testified (Sum. 293, A. 107-108), "The basic responsibility would rest with the Post Office Department in establishing their needs."

On January 9, 1950 this Court handed down its decision in the leading tax case of *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451. This case announced a new rule under which, if Gulf dissolved Joliet and acquired its assets before sale to the Government, Gulf could deduct a resultant tax loss, even though negotiations began before dissolution. The importance of this decision was immediately headlined by the leading tax services. Commerce Clearing House, Standard Federal tax reports No. 5, January 11, 1950; Prentice-Hall, weekly Federal Tax Report Bulletin, January 12, 1950; "Taxes, the Tax Magazine", February, 1950, p. 104.

In January, 1950, Gulf ordered an appraisal of the Harrison Street property by Coverdale & Colpitts for the purpose of its sale to the Government. (Finding 85, A. 138). The appraisal cost $24,764.51. (Sum. 312, A. 114.)

On February 1, 1950, the main briefs had been filed in the pending appeal before this Court from Judge Igoe's decision and the case was awaiting oral argument. There was no change in the trend of judicial decisions in the intervening months, or in the view of Gulf's legal advisers, as to the chances of success; they did not know why Mr. Hicks decided to buy the minority stock in February of 1950 rather than await the decision on appeal. (Sum. 174, 244, A. 64, 87-88.)

About February 1, 1950 Gulf decided it could afford to pay as much as $259 a share for the minority

Joliet stock, and immediately thereafter sent Mr. Scruggs, its Consulting Engineer, by train from Mobile, Alabama, to New York City to buy the stock. His instructions were to buy at the lowest possible price,—just as if Gulf were buying General Motors stock in the open market. He approached plaintiffs through the brokers Adams & Peck, and a price of $239 net to the plaintiffs (which included $14 per share of unpaid dividends) was agreed upon. (Sum. 199, 200, 211, A. 71, 75; Findings 50-53, 55-62, A. 128-131.) The nominal purchaser was Gulf's wholly-owned subsidiary Gulf, Mobile & Ohio Land Co., which then transferred the shares to Gulf in exchange for $150 par value of Gulf's 4% bonds. The sale was ratified at a special meeting of the Gulf Executive Committee in Mobile on February 10, 1950, the minutes of which recorded the following statement (A. 169-170):

> (Mr. Hicks) "It does appear, however, that substantially all the Joliet and Chicago stock not now owned by this Company can be purchased for $240 per share each. While the management is of the opinion that circumstances justify the payment of such a price and it would be advantageous to the company to do so, the company is not in position to do it without the use of the bonds authorized to be issued in exchange for the Joliet and Chicago stock."

Adams & Peck thereafter bought all the remaining minority stock, following the same procedure, and paying the same price, except that $250 was paid for the last 17 shares on April 13, 1950. (Sum. 260, Finding 63, A. 96, 131-132.)

Fourth Assistant Postmaster Myers, who was in charge of the purchase for the Post Office Department, was very well acquainted with Mr. Hodes, as Mr. Hicks knew, though he at first denied it. (Sum. 202, 215, A. 71, 72, 76, 77.) After a telephone conversation with Mr. Myers, Mr. Hicks wrote a joint letter dated April 11, 1950 to him and to Mr. Reynolds, offering the property at $8,271,000.

The minutes of Gulf's Board of Directors dated April 14, 1950 (Sum. 250, Finding 105, A. 90-91, 144) state:

> "Mr. Hicks reported the status of negotiations for the sale to the Government of our Harrison Street facilities in Chicago. He stated that it had been hoped that the proposed sale might be consummated in time to provide funds for the purchase of needed additional equipment but since it does not now appear that this can be done, it is desired that the Board authorize the acquisition of eight new Diesel units expected to be delivered by American Locomotive Company this summer and four new Diesel units expected to be delivered by General Motors Corporation (Electro-Motive Division) about the same time, as well as 100 70-ton covered hopper cars to be delivered by American Car and Foundry Company in June, to be financed temporarily under conditional sale contracts providing for payment of the full purchase price, with interest at the rate of 2% per annum, on or before June 1, 1951, which would be assigned by the respective manufacturers to The Merchants National Bank of Mobile as Trustee in behalf of itself and associate banks."

Pursuant to application dated April 10, 1950 and filed April 13, 1950, which stated it had acquired all Joliet's stock, Gulf secured authorization on June 7, 1950 from the Interstate Commerce Commission to acquire Joliet's properties. On June 20, 1950 Gulf dissolved Joliet. (Finding 64.)

Mr. Hicks deposed on direct examination that Gulf was up against "some disability" unless it acquired all Joliet's stock, and that "I am not informed legally as to whether we could liquidate the corporations and apply the physical properties or not * * *." (A. 166.) He also deposed that "In the whole course of proceedings from the time G. M. & O. '(GULF) retained Mr. Hodes, Mr. Hodes never heard any intimation that the proceedings had struck a snag, so that they would not go through." (Sum. 218, A. 77.)

On September 13, 1951, Gulf received from the Government payment of $6,550,082.82 for the Harrison Street properties. Gulf's expenses of sale were fees and expenses to Arvey, Hodes & Mantynband, $240,368; fees and expenses to Coverdale & Colpitts, $24,764; Payment to Chicago Title & Trust Co., $24,833. (Sum. 312, A. 114.)

The amount realized by Gulf from the sale to the Government was at least $4,000,000 more than it could have realized from sale to any other person at the time. (Findings 71-75, 78; A. 134, 135, 136.)

## Questions Presented

1. Was the case properly referred?

2. Is a majority stockholder, in complete control of the management of a corporation, when buying

its minority stock, bound to disclose pending negotiations for a highly profitable sale of a substantial part of the corporate assets?

3. In such a transaction, is a special tax advantage accruing to the majority stockholder through the acquisition of the minority stock a material fact which should be disclosed prior to purchase?

4. In such a stock transaction, if effected in interstate commerce, does the standard of the majority stockholder's fiduciary obligations depend upon the law of the state of incorporation, or upon Federal law?

5. Is a provision in the plan of reorganization of a railroad company approved by the Interstate Commerce Commission and the Federal District Court having jurisdiction, subject to collateral attack?

6. In such a transaction, is the majority stockholder required to disclose all prospective profits which it will make through the stock purchase, or need it only disclose profits which the minority stockholders will make if they retain their stock?

## Reasons Relied on for the Allowance of the Writ

1. The decision below is in conflict with the decision of this Court in *LaBuy* v. *Howes Leather Co.*, 352 U. S. 249, as to the propriety of a reference.

2. The decision below is i conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica Corp.*, 235 F. 2d 369.

3. The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western*

*Pacific R. R. Corp.* v. *Western Pacific R. R. Co.*, 206 F. 2d 495.

4. The decision below is in conflict with the Federal Securities and Exchange Act and the Regulations promulgated thereunder by the Securities and Exchange Commission.

5. The decision below purports to set aside collaterally a provision in the Alton Plan of Reorganization, after final approval by the Interstate Commerce Commission and the Federal District Court.

6. The decision below is in conflict with the unmistakable trend of the decisions of all the Federal courts.

The matters set forth in the foregoing petition are hereby adopted and made part of this brief.

## POINT I

**The instant case is in conflict with the decision of this Court in *La Buy* v. *Howes Leather Co.*, 352 U. S. 249.**

The Court below admitted that "there may be a question as to whether this was a proper case for reference," but declined to decide this question, on the ground that plaintiffs did not object. The record (A. 170-173) shows that the District Judge (serving in the same district as Judge La Buy) ordered the reference over plaintiffs' repeated objections, on defendant's representation that the trial would last a week or more (the Master finished it in less than two days). The Court below relies on plaintiffs' statement that a reference might be proper to assess damages; but this would only have taken place after an interlocutory decree in plaintiffs' favor,— an entirely different matter (*La Buy* v. *Howes Leather Co.*, *supra*, 259).

Plaintiffs submit that the reference was clearly improper, under Federal Rule of Civil Procedure No. 53, and under *La Buy* v. *Howes Leather Co.*, 352 U. S. 249; and that their opposition to the reference in open court, followed by objection to confirmation of the

report on this ground (A. 154), and argument of the point before the Court of Appeals, were adequate steps to preserve their rights. Indeed, such seems to be the normal procedure; for while this Court seemed unanimous in the *La Buy* case in deeming the reference improper, four judges dissented on the ground that mandamus was not the right remedy, and that correction of the error must await review by appeal.

This Court will readily observe the additional obstacle of expense and delay which the procedure of the District Court, not corrected by the Court of Appeals, places in the path of defrauded minority stockholders. These plaintiffs are faced with a bill of costs of over $8,000. (A. 164) in a case as simple as this, where the facts were clearly established by the depositions and exhibits, before trial, and the Master found (Sum. 56, A. 30) that "There was no conflict in the evidence except on the issue of the fair value of Joliet shares in 1950." In a really complicated factual situation, the threat of an even more staggering bill of costs might be as effective in preventing the assertion of minority rights as the decision below on substantive questions.

The abuse of references has been a matter of keen and growing interest. It was recently discussed at length by Federal District Judge Irving R. Kaufman, in 58 Col. Law Rev. 452, 455-459. We submit that the abuse in this case (initiated, as might be expected, by the defendant) was so gross, and the possible scope so far-reaching and dangerous to defrauded minorities, as to call for drastic correction by this Court.

## POINT II

**The instant case is in conflict with the decision of the Third Circuit Court of Appeals in *Speed* v. *Transamerica*.**

The decision in *Speed* v. *Transamerica Corp.* (C. A. 3) 235 F. 2d 369, affirming 99 F. S. 820, which was the culmination of a long series of preliminary decisions in the District Court and the Court of Appeals, was a landmark in the long series of judicial decisions and legislation protecting minority stockholders against predatory majorities. Professor Loss, Securities Regulations (1951 ed., p. 835) rightly described that case as "one which bids fair to become a leading case under Rule X-10 B-5." There, the defendant Transamerica Corporation was the principal and controlling stockholder of Axton-Fisher Tobacco Co. Axton-Fisher had a large inventory of tobacco, which had increased greatly in value. Transamerica decided to buy out the minority stockholders and then sell the inventory of Axton-Fisher. It circularized these stockholders, offering to buy their common stock at $12 a share, enclosing a balance sheet which showed the tobacco inventory at *cost*, not at the greatly increased market value. After acquiring substantially all the B stock, Transamerica dissolved Axton-Fisher and some time later sold the tobacco inventory (which meantime had a further large increase in value), making a profit of several hundred per cent on its stock purchases.

The plaintiff minority stockholders who had sold their stock sued Transamerica in the Federal District

Court under Rule X-10 B-5 of the Securities and Exchange Commission, contending that Transamerica intended to sell Axton-Fisher's inventory when it offered to buy their stock, and that this, combined with the failure to disclose the greatly increased earnings and the great increase in value of the tobacco inventory, violated Rule X-10 B-5. (99 F. Supp. 820.) The District Court found that Transamerica did have such an *intention* (though concededly it did not actually *sell* the inventory for a considerable time after the dissolution) 99 F. Supp. 825 *et seq.*:

> "The non-disclosure of the inventory profit according to historical and orthodox practices may have had little significance—considered abstractly. The reason could be urged that while such fact might not be known to each individual shareholder, it would, however, be known in tobacco and financial circles. This knowledge would, of necessity, be reflected or discounted in the price at which the stocks sold on the public exchanges. In fact, plaintiffs and the SEC both reluctantly admitted the asset or real value would not be a significant factor in the absence of a plan to liquidate, etc.
>
> * * * *
>
> "The price offered in the letter of November 12, 1942 was certainly a fair price to the public minority stockholders of Axton-Fisher—but only under the assumption that *no liquidation etc., was to take place.*
>
> * * * *

(p. 827:)

"Since I find the existence of such a plan to be a fact, it follows defendant must respond in damages."

(pp. 828, 829:)

"The rule is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers."

* * * *

"In this particular relationship, the injured party is not held within the limitations of the difference between price received and fair value of article sold. The injured party is entitled to require the perpetrator to disgorge gains made at the expense of the injured. I said: '* * * Some courts have called this a fiduciary duty while others state it is a duty imposed by the 'special circumstances'. I have already determined defendant was an 'insider'. As such, defendant was master of the corporate household and could not rely on arm's length dealing with its minority."

The Third Circuit Court of Appeals affirmed in all respects, except that it increased the pre-judgment rate of interest from 2% to 4%. Its opinion states (235 F. 2d 369, 373):

"In this court Transamerica does not seriously argue that the legal conclusions drawn by the

district court do not follow if the factual premise is accepted."

In *Speed*, as here, the defendant made no secret of its desire to acquire all the minority stock. The fraud in *Speed* consisted in the concealed *intent* (there being no overt action) to sell the assets of the affiliate after all the stock was acquired, rather than to continue its operation as a going business. So here, the defendant had disclosed its intention to acquire all the stock of Joliet and to take over its assets in its application to the I. C. C. in August 1947. But defendant made no disclosure when buying plaintiffs' stock in February 1950 that it then had not only the *intention* of selling for cash at a highly favorable price a considerable part of Joliet's assets, but that *negotiations for the sale were in progress and approaching consummation;* that this transaction included as an inseparable part the simultaneous sale, on equally favorable terms, of Gulf's property, the joint properties then being a white elephant on Gulf's hands, on which it had just lost a million three hundred thousand dollars a year in revenue due to the Baltimore & Ohio's withdrawal; that if Joliet were dissolved in time, the extraordinary profit of four millions from the sale could not only be realized free of tax, but Gulf would in addition benefit by a tax saving of a million and a quarter dollars; and further that probably to complete this sale, and certainly to get the tax saving, Gulf must acquire all the minority stock.

The reference in the opinion below to the *Speed* decision shows that the court did not discern its reasoning. The court says that "the huge profit" (in the tobacco inventory) "was assured before the shares

were purchased." But in fact a large part of the profit accrued *after* the purchase, for which the defendant was also held accountable. And the court below missed the main point of *Speed*, which was that the secret intention of Transamerica to sell the inventory in the future was the crux of the case; the court found that but for this intention, the price paid was fair. The future course of tobacco prices in *Speed* was much more uncertain than the sales price to the Government at a huge profit in this case, where Gulf could have accepted the Government's lowest offer at any time and still made almost as huge a net profit, due to the hidden windfall in the Joliet's tax cost. And whereas in *Speed* there was the bare intent to sell later, in the present case the defendant's negotiations had progressed so favorably that at some period prior to its directors' meeting on April 14, 1950, it admittedly expected payment before the summer! And the inference is inescapable from the conceded facts that the chief reason it did not realize this expectation was its need to buy all the minority stock and get clear title to all the property before selling it to the Government.

The court below thought it "hardly conceivable that the court in *Speed* would have reached the result it did if the plaintiff shareholders in that case had been limited in their rights as they are here." But the court in *Speed* said that the plaintiffs there got a price "some 33½% above the market price" (99 F. S. 825, which would have been perfectly fair were it not for Transamerica's undisclosed intent to liquidate, and that Transamerica "purposely failed to make the mentioned disclosures for the express purpose of inducing the minority stockholders to sell their stock at

what appeared to be a good price, but in fact, was not."

The court below said that "plaintiffs as shareholders of Joliet had no right to share in the proceeds of the sale by Gulf to the Government or in any income derived from the investment of such proceeds." It would seem more pertinent to say that without the consent of the plaintiffs and every other Joliet stockholder, Gulf probably had no right to make the sale at all, and certainly had no right to get the unrestricted use of the proceeds or the benefit of Joliet's $2,441,015. tax deduction. It is true that if the sale to the Government had by some extraordinary mischance failed to materialize, the Joliet stockholders might have only been entitled to their $7.00 annual dividends till such time as Gulf felt obliged to pay them a fair price. But so in *Speed* if Transamerica had decided *not to liquidate*, the minority stockholders would never have received the huge liquidation profits. And whenever the property was sold, Gulf would get the benefit of the hidden high tax cost of the Joliet's realty, which was thus a permanent asset.

What makes this case unique in the history of minority stockholder litigation is that Gulf was a second offender, having been found guilty of misusing its powers of control to freeze out the minority only a few months before, and consummating its second breach of trust while the appeal from the earlier decision was still pending.

## POINT III

**The decision below is in conflict with the decision of the Ninth Circuit Court of Appeals in *Western Pacific R. R. Corp.* v. *Western Pacific R. R. Co.***

Perhaps the most extraordinary departure in the opinion below from well-established principles of law was its treatment of the huge tax windfall which accrued to Gulf through buying all the minority stock. The court was surprised that "plaintiffs go to the extreme position of asserting that they are entitled to share pro-rata not only in profits realized by Gulf on its sale to the Government but in tax benefits which accrued to Gulf by reason of the transaction." Beyond characterizing this "extreme position" as a "nuisance value," the court does not give any reason for disregarding this asset, except to repeat that plaintiffs were limited to $7.00 per share.

One would have supposed by now that the importance of tax benefits in valuing shares would be plain to all, for since the advent of high tax rates it has become a commonplace in all financial dealings. That it is a legitimate and sometimes a vital factor in assessing the fairness of dealings with minority stock was the key issue in the extensive *Western Pacific* litigation, which was finally decided by the Ninth Circuit Court of Appeals in 206 F. 2d 495, cert. denied, 346 U. S. 910. The court there recognized the force of Mr. Justice Jackson's pithy comments in 345 U. S. 247, 273, but in applying them found that there had been no over-reaching by the controlling interests, because "all the transactions were open and above-

board and were carried on in plain sight of all concerned," by officers of the court. What a contrast to the instant case!

The hidden tax windfall here amounted to $1,269,321.05 to Gulf. It arose because the original tax cost to Joliet of the property sold, going back to March 1, 1913 and beyond, produced a tax loss of $2,441,015. and this loss was a fully deductible ordinary loss, not a "capital loss," as erroneously stated in Finding 104. (A. 143, 144.) Ironically, the opinion below states that Joliet had "no chance for capital gains or losses," when in fact, if the plaintiffs had not sold their stock, Joliet would have realized the above loss, of practically no benefit to it or to Gulf in that event, but worth 52% of face value to Gulf if Joliet were dissolved without delay. And Gulf could only effect dissolution through buying all the stock, because its early charter date made the common law rules applicable. *Union Mutual Life Ins. Co.* v. *Frear Stone Mfg. Co.*, 97 Ill. 537, 545.

The importance of this asset in evaluating the value of Joliet minority stock to Gulf may be realized by comparing the huge tax saving with the 15,000 shares of Joliet outstanding, and the much smaller amount owned by the minority stockholders. Further, the benefit of the tax was a permanent and continuing asset to Gulf; even if its net earnings, which were four million in 1949 and eight million in 1950, as shown by Moody, had been sharply reduced in 1951 (actually they were shown in Moody as over six million), the carry-back provisions would have given Gulf the same benefits. These earnings figures are interesting as showing that the five million tax-free

profit made by Gulf from selling this white elephant to the Government (with plaintiffs' unwitting help) exceeded the total net earnings of the entire Gulf system for the year 1949!

Gulf knew on February 10, 1950 that by acquiring all Joliet's stock and dissolving Joliet before consummating the sale, it would acquire a tax loss of about two and a half million dollars, which would be realized as soon as it completed the sale. Defendant could have made its April offer just as well in February 1950, and the obvious explanation for the two months' delay was the necessity of buying up the Joliet minority stock in the intervening period. Having accomplished this, Gulf was in the fortunate position, due to the tax situation, of knowing that even if it accepted the Government's lowest offer of $5,300,000., it would realize net after taxes only about $500,000. less than it ultimately received. This amount being $3,500,000. more than it could obtain elsewhere (besides the tax saving of over a million dollars) Gulf knew at all times that it could make a highly profitable sale to the Government, and that explains why Mr. Hicks never attempted to interest any other purchasers, after he initiated negotiations with the Post Office Department with the assistance of Mr. Hodes. Moreover, even if contrary to Gulf's expectation the apparently assured Government sale fell through, Gulf would have gained by dissolving Joliet an assured ultimate tax benefit of 52% of any diminution in the price which it received from any one else for this white elephant which it intended to dispose of as soon as possible.

This was also the situation in *Strong* v. *Repide*, 213 U. S. 419, when the fiduciary had a profitable offer to purchase when he bought the minority stock, which he subsequently bettered, as Gulf did here. The attempt of the court below to distinguish the two cases seems groundless.

## POINT IV

**The decision below is in conflict with the decisions of the Court of Appeals for the Tenth and Second Circuits and for the District of Columbia in *Durnett* v. *Auer*, *Hughes* v. *Securities & Exchange Comm.*, and *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.***

The court below evidently assumed that the fiduciary standard required of Gulf here was fixed by the law of Illinois, for it relies on two old decisions (*Hooker* v. *Midland Steel Co.*, 215 Ill. 444, and *Bawden* v. *Taylor*, 254 Ill. 464), which held that "a director may buy from an individual stockholder practically on the same basis as from a stranger." In applying this archaic rule to the present case, even if Illinois law were the criterion, the decision below is squarely in conflict with the decision of the Tenth Circuit Court of Appeals in *Durnett* v. *Auer*, 71 F. 2d 912, which held that this Illinois rule could not apply to a plan to buy all the stock and take over all the assets of a corporation. The decision below is also in conflict with the decision of the Fifth Circuit Court of Appeals in *Mansfield Hardwood Lumber Co.* v. *Johnson*, rendered February 20, 1959, 263 F. 2d 748 (a diversity case like *Durnett* v. *Auer*, *supra*).

Further, the decision below was in error here in failing to give paramount effect to the Federal Securities and Exchange Act and the Regulations of the Securities and Exchange Commission (Rule X-10 B-5) which in interstate transactions like these would supersede any contrary State rule of law. Federal supremacy in this field was squarely upheld in *Hughes* v. *Securities & Exchange Commission* (C. A. 2), 139 F. 2d 434 and in *Norris & Hirschberg, Inc.* v. *Securities & Exchange Comm.* (D. C. App.), 177 F. 2d, 228, which are in direct conflict with the opinion below on this major principle. The State of Illinois could not charter its citizens to defraud minority stockholders in other States in defiance of Federal law. And, as was said in *Zahn* v. *Transamerica Corp.* (C. A. 3), 162 F. 2d 36, 44, "The tenor of the federal decisions in respect to the general fiduciary duty of those in control of a corporation is unmistakable."

Not only is there thus a direct conflict of decision between circuits on the question whether the Federal rule as to the fiduciary duty of majority to minority stockholders in interstate security transactions is paramount to the law of the state of incorporation, but this is an important question of Federal law which has not been, but should be settled by this Court.

## POINT V

**The decision below is in direct conflict with an important provision of the plan of reorganization of the Alton Railroad Company, which became final on May 31, 1947, after approval by the Interstate Commerce Commission and the Federal District Court having jurisdiction.**

The opinion below relies heavily on a dictum in its majority opinion (also written by Judge Major) in *Joliet & Chicago R. R. Co.* v. *United States* (1941), 118 F. 2d 174, 176, that "there is little, if any, question that the indenture of 1864 divested the plaintiff 'Joliet' of all right, title and interest in the property, and vested a full and indefeasible title in the grantee, its successors and assigns."

This dictum was based on two Illinois decisions. In the first, *Huck* v. *Chicago & Alton R. Co.*, 86 Ill. 350, the court held (pp. 354, 355) that in view of the Joliet lease provisions, including the lessee's covenant to pay all taxes on the demised premises, and of the Illinois statute which taxed railroads on property, *operated*, whether it was *owned or leased*, the lessee "is, for all purposes of taxation, if not for all other purposes, to be regarded as the owner of all the leased property." In the second, *Chicago, Burlington & Quincy R. Co.* v. *Boyd*, 118 Ill. 73, the court remarked that a Burlington indenture (terms not stated) was equivalent to a conveyance. Neither of these cases decided that Gulf here could convey title to Joliet's property; Judge Major's 1941 opinion ruled that Joliet's corporate entity could be disregarded for Federal income tax purposes, but it was unanimously

reversed by this Court. These two aspects of Joliet's ownership were the only ones involved in the instant case. In the 1941 case, Judge Major accepted the admission of Joliet (against its own interest but in favor of its majority stockholder and lessee) that it had no rights in its own property. Evidently the provisions of Ill. Rev. Stats. C. 80, sec. 8, specifically providing for forfeiture of the lessee's interest for non-payment of rent, were not called to the court's attention. No individual Joliet stockholder was a party to that suit.

Whatever the validity of these contentions of defendant's predecessors may have been in the past as applied to the various situations involved *supra*, they became moot when the Joliet stockholders required the Gulf as part of the Alton Plan of Reorganization to admit that the Joliet property was only *leased*, and not *conveyed*. This language was used to insure Joliet's stockholders against future misuse of their property by the new lessee. It was agreed to by all the parties in interest, and approved by the I. C. C. and the Federal District Court. We are at a loss to understand the statement of the court below, that it could not discern "how this provision altered a situation which had been in existence and recognized by the parties" (sic) "for almost a century." This statement is erroneous in its assumptions in the first place, but in any event it seems most usual that reorganizations in bankruptcy should change previous contractual relationships.

The action of the court below in collaterally nullifying this provision of the Alton Plan seems unprecedented.

## POINT VI

**The decision below is in conflict with the unmistakable trend of the decisions of all the Federal Courts in this century.**

The opinion below shows an unusual blindness to the fiduciary duties required by this Court to be observed by a controlling majority stockholder like Gulf.

Even the Special Master here specifically agreed with Judge Igoe's findings in the previous case that Gulf had previously violated its fiduciary duties toward the minority stockholders. This violation (which of course could not occur till after Gulf acquired control early in 1948) consisted in continuing the stoppage of dividends as a means of forcing the minority to sacrifice their stock. The court below evidently disagreed with the Master's criticism of this conduct, for it could not discern the reason why dividend payments were stopped, though the purpose, to put pressure on the minority, seems obvious. The court further said "this contention" (of damage due to dividend stoppage) "is not pressed here,"— an error hard to comprehend in view of the following quotations from plaintiffs' main brief below:

> "This scheme was initiated before Gulf took control. * * *
>
> "But however disingenuous Gulf's course of action may have been before it took control, no violation of fiduciary duty was involved. Assumption of control created an altogether different situation. Gulf's conduct thereafter which was found wrongful by Judge Igoe was evidently

its continued failure to pay the taxes, combined with its continued warnings to the minority stockholders of their predicament. While Gulf was within its legal rights in litigating by way of a declaratory judgment its tax obligations under the lease so long as Joliet was independent, however unfounded or absurd Gulf's contentions were, Judges Igoe and Sullivan were evidently agreed that it had no right after assuming a fiduciary relation to the minority to continue its refusal to pay Joliet's taxes in order to force them to sell their stock, at least without probable cause.

"The Master specifically found (111, A. 146) that Judge Igoe's decision 'was well founded in law and the possibility of its being set aside on appeal was practically nonexistent.' But he reached the extraordinary conclusion (Conclusion 124, A. 149) that while Gulf's conduct 'in 1947 and 1948' was 'properly criticized' by Judge Igoe in his decree and findings of June 1949, those matters are not relevant to the issue in the present case, as they had no effect upon plaintiffs' judgment when plaintiffs sold their Joliet stock in February 1950, and plaintiffs were fully informed as to such matters before they sold their stock.'

"The Master evidently overlooked the fact that the main item of misconduct of which Judge Igoe found defendant guilty was in continuing to deprive Joliet stockholders of their dividends after G M & O had assumed its fiduciary obligations to these stockholders in 1948. This misconduct continued up to February 10, 1950. The continuing nature of the misconduct appears clearly from Judge Igoe's findings.

The misconduct of which Judge Igoe found the defendant guilty—the scheme of the majority stockholders to deprive the minority holders of all dividends, so as to force them to sell—of course was not limited to 1947 and 1948, as the Master supposed, but operated with cumulative effect throughout 1949 and until the plaintiffs sold their stock in February, 1950. If anything, the misconduct became more gross after Judge Igoe had held defendant liable for the taxes in his brief oral opinion on April 25, 1949 and certainly after his detailed findings in June, 1949 had put the defendant on notice that it had been and was violating its fiduciary obligations.

"If the Court below was correct in finding that 'the possibility of' (Judge Igoe's decision) 'being set aside was practically non-existent,' then it must follow that the defendant was compounding its violation of fiduciary duty by prosecuting an appeal from this decision with the apparent sole purpose of cheating its *cestuis que trust* of their current income,—a particular hardship on the two educational institutions which represent more than one-third of the plaintiffs' stock. And the conclusion seems naive (Conclusion 124, A. 149) that because the plaintiffs were fully informed of the oppression perpetrated on them, *they were not influenced* by it in evaluating their stock. Judge Igoe's finding of breach of duty was based not on fraudulent concealment, but on active misfeasance. This court will certainly take judicial notice that if the defendant had before offering to buy plaintiffs' stock dismissed its appeal from Judge Igoe's decision and

paid the arrears of dividends (which with interest would have amounted to nearly $15 a share), the plaintiffs' bargaining position would have been definitely strengthened. It needs no argument to prove that stocks receiving regular dividends generally command a better price than those paying none at all due to litigation no matter how groundless the litigation may be. And here the plaintiffs were confronted by a powerful and unscrupulous antagonist, represented by astute counsel. The Blackstone Library and the Norwich Free Academy could not pay their librarians and teachers with hopes or assurances.

"Just how much more the plaintiffs would have asked for their stock had the defendant acted conscientiously in this respect is (as often in assessing damages) a somewhat difficult question of precise amount. However, the defendant, whose breach of duty created the uncertainty, should not be permitted to profit by it, the rule being stated as follows by Judge Learned Hand in *Gratz* v. *Claughton* (C. A. 2), 187 F. 2d 46, 51, cert. denied 341 U. S. 920:

> 'The situation falls within the doctrine which has been law since the days of the "Chimney Sweeper's Jewel Case," (*Armory* v. *Delamirie*, 1722, 1 Strange 504) that when damages are at some unascertainable amount below an upper limit and when the uncertainty arises from the defendant's wrong, the upper limit will be taken as the proper amount.'

"So in *Palmer* v. *Connecticut Ry. Co.*, 311 U. S. 544, 561, the Supreme Court said in referring to an analogous case of willful infringement

of the copyright of a play by a motion picture company, 'a situation where damages are difficult of proof':

> 'No expert thought any greater percentage than ten should be attributed to the play. *The lower court allowed twenty so that the award might by no possibility be too small.* We approved because "what is required is not mathematical exactness but only a reasonable approximation." That, after all, is a matter of judgment * * *' (Emphasis supplied.)

"Here the defendant had decided it could afford to pay $244 a share plus dividend arrears. Mr. Hicks admitted (Dep. 95) that defendant was 'prepared to pay $259 if necessary.' We believe it reasonable to infer that *on the sole basis of the improvement in their bargaining position due to such assumed prior payment of the dividend arrears and dropping of the appeal* the plaintiffs would have raised their asking price from $225 (ex-dividend) to $244 per share. At any rate, it is obvious that their bargaining position would have been somewhat bettered by defendant's belated abandonment of its unlawful conduct, and under the doctrine stated by Judge Hand and the United States Supreme Court quoted *supra*, the defendant having wrongfully prevented bargaining on a fair basis, is chargeable with the highest possible figure that fair bargaining could have produced. We know that that price was at least $259, for the defendant has admitted as much. Indeed, it is arguable that as a fiduciary Gulf was bound to disclose the decision of its executives that it would pay $259 per share.

"So much for the continued active oppression of the minority by wrongful withholding of their dividends. We now turn to the fraudulent concealment of the Harrison Street situation, practiced by the defendant, which involved much larger damages."

The court below construed the above argument as not pressing the contention that the continued stoppage of dividends damaged the plaintiffs! Another curious error is its statement that "In our opinion, the most that can be said of Gulf's situation was that it was anxious, as it had been for several years, to sell the Harrison Street property, and that it had hopes, perhaps with some reason, of consummating a sale to the government." The reference to "several years" is wholly groundless, and the mistake is important, because it shows confusion in the court's mind between Gulf's long-range plan to squeeze out the minority—which did last "several years"—and the sudden necessity for sale of the Harrison Street land, which arose only in April, 1949, when the B. & O. gave notice of cancellation. This cancellation in turn led to Gulf's strenuous efforts to rid itself of the white elephant, all of which had failed when Gulf as a last resort approached the Postmaster General and retained Mr. Hodes's firm in November 1949.

Such unusual errors as those just mentioned are hard to explain, unless they were perhaps due to the fundamental misconception of the court below, based on its unsound and out-dated 1941 dictum that Joliet did not own its property, and that its stockholders had only a contractual right to $7. per share annual dividends and nothing more. This may have made the

court less careful in examining the more pertinent issues.

The same predisposition led the court completely to misunderstand Mr. Gardner's testimony that no investor would "buy Joliet stock on a yield basis at a price of $240. per share." The whole point of Mr. Gardner's testimony (A. 33-35) was that Joliet's value was *not* limited to a *yield basis*, and he referred to the analogous and well-known case of the "New York & Harlem Railroad, which is leased to the New York Central for 400 years, and which has valuable real estate interests" near Grand Central Station. It is controlled by its lessee, and is limited to a $5. annual dividend, but its stock has been traded on the New York Stock Exchange "at prices ranging from $300. to $600. per share." Mr. Hall, Gulf's expert, knew so little about guaranteed stocks that he had never heard of New York & Harlem (one of the best-known leased lines, and the closest analogy to Joliet) before the hearing, and of course "did not know what made the Harlem stock so valuable" (A. 99). The court below quoted as authoritative Mr. Hall's untenable view that "leased line securities are, in effect, bonds rather than stocks."

These unsound views, expressed below, if not corrected, would endanger the property rights of the stockholders in dozens of leased line railroads in the United States, which are controlled by their lessees. The opinion below in effect invites such lessees to violate their fiduciary duties, by placing a ceiling on their liability—the capitalized value of the guaranteed dividends—and allowing them to retain any surplus prof-

its which they may make from secret dealings with the lessor's fee ownership.

Despite Mr. Hall's contrary opinion, apparently shared by the court below, the fact is that long-term and even perpetual lessors do retain the fee ownership of their properties, and when a conveyance of the fee is required, as in the case of the Post Office deal here, or when questions of Federal income tax liability are involved, as here, and as was held by this Court in *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, the lessor's ownership must be recognized.

The same misplaced concentration on the supposed limitation on plaintiffs' rights must be responsible for the failure of the court below to apply one of the most elementary principles of fiduciary law, that the fiduciary is bound to account for the profits he makes from unfair dealings, and that his liability is not limited to the damages he inflicts on the beneficiary.

The court below also neglected the rule referred to in *Pearlman* v. *Feldmann* (C. A. 2), 219 F. 173, 177, that "fiduciaries always have the burden of proof in establishing the fairness of their dealings with trust properties." Let us bear that principle in mind in outlining below merely the highlights of Gulf's conduct.

Gulf's frantic haste in making the Joliet stock purchases proves that it was an emergency matter. Actually, defendant's "long-range plan" for Joliet had been to starve the minority into submission by an indefinite suspension of dividend payments, and this plan had still several months—possibly nine months—

of life before the appeal would be decided by the Circuit Court of Appeals (Sum. 244, A. 87, 88), with a possible further delay by application for a writ of certiorari. During this period defendant might have hoped to buy a sizeable amount of stock from tired or needy holders; Adams and Peck bought 100 shares on February 8, 1950 at 180 (Sum. 264, A. 97) and defendant might well have hoped to pick up many hundreds at near that price. True, this would have violated the Interstate Commerce Commission's order as to price, but defendant showed no hesitancy here in committing a flagrant wholesale violation of that order, through the instrumentality of its wholly-owned Land Company. Moreover, by acquiring 8,619 Joliet shares previously, defendant had already effected 57½% of the annual tax saving in Joliet corporate taxes which was a main original objective in buying the stock. Besides, Mr. Hicks testified that his lawyers advised him at this time that there was as good a chance as ever of winning the appeal.

Even if the carefully planned scheme of coercion were to be thus suddenly and inexplicably abandoned, after incurring the expense of preparing and printing the record and briefs on appeal (Sum. 244, A. 87, 88), there was no apparent reason for the emergency move of sending an important executive in person from Alabama to New York at almost a moment's notice, to stay there until the purchase of the bulk of the stock was completed, instead of merely placing the purchase order in the hands of Adams & Peck for execution; or for the further emergency move of buying overnight about $1,200,000 worth of Joliet stock in apparent violation of the Interstate Commerce Commission's order.

When Gulf began its proceedings to buy Joliet stock in 1947, it was content with the leisurely but lawful processes of the Commission, though then its routine annual taxsaving possibilities were more than double what they were in February, 1950. Obviously there was an emergency at the latter date.

We shall point out below what seem to be the only possible motives for the hasty and possibly illegal stock purchase. These motives were inextricably connected with the Post Office deal.

We have seen that January was the month when a very quick closing was expected. Mr. Hicks testified that it was in January, 1950, that he asked Mr. Scruggs to make his calculation. (Sumr. 157, A. 60.) Some time during the month of January, or February before the 6th (accepting Mr. Scruggs' date), the defendant must have been apprised of two extremely important considerations, the first seriously endangering the whole deal, and the second making it much more profitable, if consummated. The first was the fact that the government would only be interested in acquiring a clear title to the fee, a substantial part of which belonged to Joliet, not to Gulf; the second was that if Gulf could get the fee of Joliet's share before completing the sale, there was a potential net tax saving of an extra $1,200,000. Both these problems could be solved by the immediate purchase of all the minority Joliet stock and the dissolution of Joliet before title was conveyed to the government, and (as appears *infra*) in no other way.

Having the burden of proof to explain this sudden purchase, Gulf offered only two reasons—first, Judge

Igoe's decision *nine months* before, from which meantime it had been prosecuting an appeal with eminent counsel, who had printed the record and briefs; second, that a month before, it had completed the liquidation of another leased line—an uncontested proceeding begun in 1947, which was wholly irrelevant to the Joliet situation. These reasons were so trivial compared with the extraordinary emergency action of buying the Joliet stock in the circumstances outlined above, that we suggest that their only importance is to show Gulf's guilty realization that to admit the true and obvious explanation—the pending Post Office sale—would inevitably result in an adverse decree in the instant case.

Mr. Hicks himself admitted that unless Gulf acquired all Joliet's stock, it was up against "some legal disability" and he did not know if they could liquidate the corporation and "apply the physical properties" otherwise. The statement under the circumstances certainly meant that there was doubt whether Gulf could consummate the bonanza deal (of which Joliet's realty was an essential ingredient) without buying all the Joliet stock.

Mr. Hicks's doubts were fully justified. Joliet's charter antedated the present Illinois Constitution and the Revised Statutes, so that the rights of its stockholders were governed by the common law, under which their unanimous consent was certainly required to dissolve the corporation, and probably required to sell a substantial part of its assets outside the usual course of business. *Cf.* the long history of the celebrated Central of Georgia Railway litigation, finally decided in favor of the lessor's minority stockholders

on April 10, 1950. (*South Western R. Co.* v. *Benton*, 206 Ga. 770) with which Gulf's attorneys were undoubtedly familiar.

Furthermore, Gulf was now in danger of being hoist with its own petard in the pending appeal from Judge Igoe's decision in the dividend action. Evidently this litigation must be immediately ended, if Gulf was to convey a clear title to the Joliet property, as was shown by Mr. Reynolds' searching questions at the June 9, 1950 conference as to any litigation affecting title to the property. (Defendant's App. 267.) Gulf's fiduciary duty obviously required it to inform the plaintiffs of its intention to withdraw its appeal whether they sold or not. But this did not fit in with Mr. Hicks's purpose of buying their stock at the lowest possible price, as if Gulf were buying General Motors stock, and so it was concealed till after the stock purchase.

A clinching proof that the stock purchase was integrally bound up with the Post Office deal is also found in Gulf's own minutes. Mr. Hicks informed Gulf's Executive Committee on February 10, 1950 that "circumstances justify the payment of such a price * * *;" and later, on April 14, 1950, stated to Gulf's Board of Directors "that it had been hoped that the proposed sale might be consummated in time to provide funds for the purchase of needed additional equipment (next summer), but since it does not now appear that this can be done," the equipment purchase should be financed temporarily till June 1, 1951. In view of Mr. Hicks's admission that after employing Mr. Hodes' firm he never had any intimation that the Post Office negotiation had struck a snag, this last-

quoted statement can only mean that at some time between November 1949 (when Mr. Hicks saw the Postmaster General on November 4, 1949 and retained Mr. Hodes' firm on November 19th and gave up all attempts to sell to others) and April 14, 1950, Gulf deemed the sale to the Government as not only assured, but as so imminent that it could be closed, and the price collected, before summer, and further that, at some later date prior to April 14, 1950, the expected date of closing was postponed to about June 1, 1951 (actually, Gulf was paid September 13, 1951), the assurance of ultimate sale being undiminished.

The undisputed admissions and circumstances already set forth raise an inescapable inference that the Joliet stock purchase was an integral part of the Harrison Street sale. But further circumstances combine to associate the two with almost mathematical precision, especially as Gulf, carrying the burden of proof, has offered no other rational explanation either of the sudden stock purchase or of the minutes.

There being 180 days between November 4th and April 14th, a purely arithmetical interpolation would point to January 23, 1950 as the likeliest approximate date when Gulf determined that the closing must be deferred till 1951.

Mr. Hicks already had Mr. Hodes's firm in mind to handle the business, and when the Postmaster General indicated approval, he retained Mr. Hodes on November 19, 1949 with a $25,000. fee, plus a 5% contingency. Knowing Mr. Hodes's intimate connections with the Post Office Department in particular and with the Democratic Administration in Washington

in general, Mr. Hicks must have felt quite hopeful when he had secured his services. His hopes must have risen far higher when things began to happen so fast immediately following Mr. Hodes's retainer. The Postmaster General came to Chicago to lunch with him, the Chicago Postmaster Mr. Haderlein (who knew Mr. Hodes) and Mr. Hodes at the latter's club in Chicago early in December, after a large delegation from Washington, together with Gulf officials and representatives of the Hodes office, had inspected the defendant's properties on December 1. This Committee made a full report of their trip on December 14, 1949.

The Postmaster General signed his "O. K." at the end of the report on December 20, 1949, saying "Note last paragraph." The next day, to make assurance doubly sure, he attached a note to the report, stating (again in his own handwriting) "I agree and we should follow rec. last par." (recommendation last paragraph). This expressed the opinion of the Committee that Gulf's Harrison Street properties were probably the most desirable site available for expansion of the Chicago Post Office facilities.

With respect to the above evidence (all documentary, or undisputed, and hence subject to unrestricted review by an appellate court) the court below said: "Although the evidence is not free from conflict, we are convinced that it furnishes ample support for the findings made by the special master, relevant portions of which are:

> "92. Prior to February 10, 1950, GM&O (Gulf) had no knowledge or information that the gov-

> ernment was giving Harrison Street property consideration more favorable than it was giving other Chicago sites proposed for acquisition by the government."
>
> * * * *

The above quotation indicates that the court below applied a wrong criterion to the special master's finding, apparently thinking it was bound to affirm unless the finding was clearly erroneous. But even if the latter criterion were applied the finding should not stand. For it seems perfectly incredible that Mr. Hodes, who was paid a fee of $235,000. for effecting the sale, and whose work was highly satisfactory to Mr. Hicks (Sum. 224, A. 80), would not have promptly found out from his good friend Walter Myers or Mr. Haderlein, or from the Postmaster General, what the attitude of the Post Office Department was. Such disclosure would not have violated any statute that we are aware of, and it is hard to understand Mr. Hicks's implication that such disclosure would have been a violation of open dealing (Sum. 206, A. 73).

The purchase required the concurrence of the Government's General Service Administration, but as its head Mr. Reynolds testified "The basic responsibility would rest with the Post Office Department in establishing its needs." None of the Post Office officials ever wavered in their preference, after December, 1949, and Fourth Assistant Postmaster General Myers, who "was very well acquainted with Mr. Hodes," was in charge of the purchase throughout for the Post Office. Mr. Post, one of the signers of the report, was General Services' representative on the Committee. (Sum. 98, A. 43-44)

Indeed, Mr. Myers was perfectly frank in championing Gulf's cause, at conferences with Messrs. Hicks and Ogden in June, 1950, both in Mr. Reynolds' presence and in his absence (Defendants' App. 270, 273), and Messrs. Myers and Reynolds advised Gulf how it could help them get Congressional approval. Incidentally, when on June 28, 1950 Gulf officials told Mr. Fisher, General Manager of the Chicago Union Station, and a Mr. Shiffer, "that the Government was going to buy all of our property," this "did not appear to be any news to them." (Defendant's App. 279). Neither Mr. Myers nor Mr. Reynolds saw anything wrong in advising Gulf openly how it could best secure acceptance of its offer, and Mr. Myers surely would have felt free to disclose the favorable attitude of all his colleagues to Mr. Hodes after his chief had adopted the report on December 21st.

But the surest proof of the clear error of the master and the court below on this point is found in Gulf's April 14th minutes. For how could Mr. Hicks have hoped to get paid before summer, and how could he still expect to be paid by June 1, 1951, unless he had been informed of the favorable attitude of the Post Office officials from the Postmaster General down? If in fact Mr. Hicks believed (as the master found) that the government (in this case represented by the Post Office Department) was giving equally favorable consideration to other sites, then his statement to the Directors would have been wildly reckless and foolish, instead of being remarkably accurate, as it proved.

Even more pertinent to the stock purchase was the second branch of Mr. Hicks's April 14th statement,—

that at some date *after* hope of immediate closing arose (in late December or January), but *before* April 14th, Gulf realized the closing must be deferred for over a year. Gulf proffered no evidence in explanation, but the inference is inescapable that the reason for the unexpected delay was the necessity of dissolving Joliet before conveying title, which in turn required buying all the Joliet stock as an essential condition precedent. For Mr. Hicks admitted that no snag in the procedure was even intimated to him at any time, and further that there was doubt if Gulf could dissolve Joliet and sell its property without buying every share. And Gulf's only extraordinary activity during this period was the stock purchase—hasty to the point of illegality as to plaintiffs' stock, followed by two months of mopping up the remaining scattered shares,—and the equally hurried dissolution of Joliet immediately thereafter. Again, in contrast to the leisurely dissolution proceedings in the other leased line, which took two years, Gulf completed Joliet's dissolution in two months.

Mr. Hicks's admissions, borne out by Gulf's actions, seem consistent only with the hypothesis that Gulf had to buy the stock to complete the Post Office deal. Gulf has suggested no other rational explanation for its Herculean efforts, which fitted in with such chronological exactitude into the Post Office negotiations.

If needed, further corroboration was at hand. When Gulf first dealt with the Post Office Department, it described the whole property as its own. This appears in its retainer of the Hodes firm (Defendant's App. 252), which refers to "disposing of certain property which we own and to which we customarily

refer as our Harrison Street properties;" and also from the Government committee's report the following month, which recommended "Gulf's Harrison St. properties." This was the time when Gulf hoped to complete the sale before summer. But in January, 1950, it must have occurred to some one that Gulf could not in any event convey good fee title to Joliet land; that the Government would not buy land, partly fee and partly leasehold, or any land the title to which was adversely affected by pending litigation; Mr. Ogden, Gulf's lawyer, admitted he might have talked with Mr. Hodes about the difficulty of selling a leasehold, and such a conversation must have taken place *after* November 19, and *before* February 10, when it became irrelevant.

Another vital element leading to the stock purchase was Joliet's tax asset; this meant a million and a quarter dollars to Gulf if it could dissolve Joliet before closing the realty deal (see p. 26-27 supra). And by a remarkable coincidence this potential tax bonanza as it affected the Post Office deal was confirmed on January 9, 1950 by this court in the leading case of *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451. This case announced a new rule under which, if Gulf dissolved Joliet and acquired its assets before sale to the Government, Gulf could deduct a resultant tax loss, even though negotiations began before dissolution. The importance of this decision was immediately head-lined by the leading tax services. Even if one could imagine that Gulf's tax advisers had not studied the tax angles of this crucially important realty deal earlier, this widely-publicized decision must surely have caught their attention.

Finally, if the court below had seriously analyzed the conduct of this cynical second offender, it could never have been so naive as to accept the master's finding that the reason why Gulf did not disclose any of the above facts to plaintiffs was its belief that the disposal of Joliet's Harrison Street properties in this hugely profitable package deal was none of their business. The truth is that Gulf's motive in concealing these highly favorable elements of value in 1950 was exactly the same as its motive in 1948, so justly criticized both by Judge Igoe and the master, in cutting off Joliet dividend payments—in both cases, to buy the minority's stock at the lowest possible price, which Mr. Hicks admitted was Gulf's intention. Actuated by this point of view, which was so improper for a fiduciary, Gulf would only by inadvertence have revealed anything to plaintiffs that would have possibly raised their asking price. And the record is crystal clear that Gulf made no such mistake, and disclosed absolutely nothing.

We respectfully submit that the decision below is not only most unjust to the minority stockholders directly involved, who after being over-reached by a faithless fiduciary are unjustly faced with a monumental bill of costs, but also would probably deprive all minority stockholders obliged to seek relief in the Seventh Circuit of the protection against predatory insiders which the Congress, the Securities & Exchange Commission, and this Court have tried to build up, particularly in the last 25 years. Indeed, this decision would set back fiduciary standards by at least a century.

## CONCLUSION

**It is respectfully submitted that a writ of certiorari should be granted.**

WATSON WASHBURN
*Attorney for Petitioners*
36 West 44th Street
New York 36, N. Y.

FILE COPY

Office-Supreme Court, U.S.
FILED
JUL 6 1959
JAMES R. BROWNING, Clerk

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1958

NO. [redacted] 102

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

*v.*

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

## BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

KENNETH F. BURGESS
D. ROBERT THOMAS
WALTER J. CUMMINGS, JR.
ARTHUR R. SEDER, JR.
*Attorneys for Respondent*
11 South La Salle Street
Chicago 3, Illinois

SIDLEY, AUSTIN, BURGESS & SMITH
11 South La Salle Street
Chicago 3, Illinois
*Of Counsel.*

TWENTIETH CENTURY PRESS, INC., CHICAGO 6

## TABLE OF CONTENTS


| | PAGE |
|---|---|
| PRELIMINARY STATEMENT | 1 |
| STATEMENT OF THE CASE | 3 |
| ARGUMENT | 14 |
| I. The Decision in this Case Is Not in Conflict with the Decisions Cited by Petitioners | 14 |
| (a) *La Buy* v. *Howes Leather Co.*, 352 U.S. 249 | 14 |
| (b) *Speed* v. *Transamerica Corp.*, 235 F. 2d 369 | 17 |
| (c) *Western Pacific R.R. Corp.* v. *Western Pacific R.R. Co.*, 206 F. 2d 495 | 19 |
| (d) *Dunnett* v. *Arn*, 71 F. 2d 912; *Hughes* v. *Securities and Exchange Commission*, 139 F. 2d 434; *Norris & Hirshberg, Inc.* v. *Securities & Exchange Commission*, 177 F. 2d 228 | 20 |
| (e) Alton Plan of Reorganization | 21 |
| II. The Decision Does Not "Conflict with the Unmistakable Trend of the Decisions of All the Federal Courts in This Century" | 23 |
| CONCLUSION | 28 |


### CASES CITED


| | |
|---|---|
| *Dunnett* v. *Arn*, 71 F. 2d 912 | 20 |
| *Friedman* v. *United States*, 168 F. Supp. 815, 339 U. S. 205 | 23 |
| *Hughes* v. *Securities and Exchange Commission*, 139 F. 2d 434 | 20 |
| *La Buy* v. *Howes Leather Co.*, 352 U.S. 249 | 2, 3, 14, 15 |
| *Norris & Hirshberg, Inc.* v. *Securities & Exchange Commission*, 177 F. 2d 228 | 20 |
| *Slater* v. *G.M.&O.*, 307 N.Y. 419, 121 N.E. 2d 398 | 8 |
| *Speed* v. *Transamerica Corp.*, 235 F. 2d 369 | 17, 18, 19 |
| *Western Pacific R.R. Corp.* v. *Western Pacific R.R. Co.*, 206 F. 2d 495 | 19 |

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1958

NO. 986

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

*v.*

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

# BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

## PRELIMINARY STATEMENT

The fourteen-page opinion of the Court of Appeals is not appended to the Petition, but it is set out following page 173 of the document entitled "Appendix to Brief of Plaintiffs-Appellants" and is reported at 264 F. 2d 445.

The Petition for a writ of certiorari is predicated upon an alleged conflict between that decision and certain decisions of this Court and of other courts. The opinion of the Court of Appeals, however, shows that no such conflict exists and that this case and the cases cited by Petitioners were decided upon precisely the same principles of law.

Both the District Court and the Court of Appeals, which unanimously affirmed the decision of the District Court, stated and applied the rule followed in the cases to which Petitioners refer, namely that a majority stockholder has

a fiduciary duty to disclose all material facts affecting the value of minority shares before purchasing those shares (A.[1] 147, 163, 164; Opinion, pp. 6, 8). After detailed consideration of the evidence of this case, however, those courts found that the Respondent (majority stockholder) had concealed no material facts from Petitioners (minority stockholders) and that Petitioners had possession of all the facts relevant to a determination of the fair value of the stock (A. 151, 163, 164; Opinion, pp. 8-13). The differences between this case and the cases cited by Petitioners are in their facts and not in the legal principles.

On the basis of the facts of this case, the decree affirmed by the Court of Appeals found expressly that:

> "Defendant did not violate the provisions of Rule X-10B-5 promulgated by the Securities and Exchange Commission pursuant to Section 10B of the Securities and Exchange Act of 1934, 15 U.S.C.A. 78(j)(b)." (A. 153, 163, 164)

Petitioners' assertion that the decision conflicts with other decisions by failing to give paramount effect to the Federal Securities and Exchange Act and the Regulations of the Securities and Exchange Commission is completely unfounded. Full effect was given to the Act and the Regulations, but the facts proved that there had been no violation.

The absence of the alleged conflict with *La Buy* v. *Howes Leather Co.*, 352 U.S. 249, is apparent from the fact that the decision which was affirmed in that case was from the same Court of Appeals which unanimously decided this later case. The District Court, on its own motion, had referred this proceeding to a special master, who heard the

1. The letter "A" refers to the Appendix to Brief of Plaintiffs-Appellants. The Supplemental Appendix of Defendant-Appellee is referred to herein as "SA."

testimony, analyzed the voluminous depositions and exhibits and reported his recommended findings and conclusions. Denying Petitioners' effort to shift the cost of that reference to the Respondent, the Court of Appeals reviewed the record and found that "at no point did they object" to the reference (Opinion, p. 14). Instead of objecting and moving to vacate, Petitioners had submitted their case to the special master. The decision here in no way conflicts with *La Buy*, where timely objections were made and motions to vacate were filed and where there had been no participation in a proceeding before the master.

Under a claim of conflict with other decisions, Petitioners merely seek an additional review of the evidence concerning the factual determinations of the District Court which were unanimously affirmed by the Court of Appeals. The case is not an appropriate one for certiorari, since it represents an application of recognized legal principles to the facts of a particular controversy. Moreover, the factual determinations made below were firmly supported by the evidence. The Petition presents no valid ground specified in Rule 19 for the issuance of the writ.

## STATEMENT OF THE CASE

The Court of Appeals summarized the nature of the case at the outset of its opinion as follows:

> "This action was commenced November 4, 1953, by former minority stockholders of Joliet & Chicago Railroad Company (herein called Joliet) against the Gulf, Mobile & Ohio Railroad Company (herein called Gulf), to whose subsidiary (Gulf, Mobile & Ohio Land Company) plaintiffs, on or about February 14, 1950, sold 4,312 shares of stock of Joliet at a price of $240.00 per share. The stock was so-called guaranteed stock, all of the property of Joliet (a railroad line between Joliet

and Chicago) having been leased in 1864 to Chicago and Alton Railroad Company (herein, with successor corporations, called Alton), under a perpetual lease. This lease was assumed by Gulf in 1947 in connection with the Alton reorganization proceeding in the district court for the Northern District of Illinois.

"The complaint sought damages of varying amounts up to the difference between $240.00 per share, the receiving price, and $1,087.70 per share, for total damages of $3,659,594.00. Plaintiffs' claim was based on Gulf's alleged stoppage of guaranteed dividend payments on plaintiffs' stock prior to purchase, and Gulf's failure, when purchasing plaintiffs' stock, to disclose material facts affecting its value in violation of Gulf's fiduciary obligations, by which Gulf was enabled to reap large profits at plaintiffs' expense. Jurisdiction is asserted upon diversity of citizenship and upon a violation of Section 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C.A. 78j (b)." (Opinion, pp. 1-2)

With reference to the perpetual lease of Joliet's property, the opinion stated in part as follows:

"As rent under the lease Alton [a predecessor of Gulf] covenanted to guarantee and pay to the holders of Joliet's 15,000 shares of stock an annual dividend of seven percent upon the par value of the stock, or $7.00 per share, payable quarterly." (Opinion, p. 3)

The Court of Appeals quoted and approved the following conclusion of the special master, which had been adopted by the District Court:

"'Joliet stockholders, in the event of a sale of part of Joliet's property during the term of the lease, would derive no benefit from such a sale, even though made at a great profit, because their dividend was limited to $7 per share.'" (Opinion, p. 11)

In its description of the facts, the Court of Appeals stated:

> "Thus, the situation of plaintiffs as shareholders of Joliet was in marked contrast to that of shareholders in the ordinary case who own the corporate assets subject to its liabilities, and where any enhancement of the value of the corporate assets results in a pro-rata increase in the value of their shares." (Opinion, p. 12)

The alleged stoppage of dividend payments arose out of the exercise by Gulf of a right which had been specifically reserved to it in the Alton reorganization plan and the lease assumption agreement of 1947. That agreement, which had been reviewed and approved by the Interstate Commerce Commission and by the District Court in the Alton reorganization proceedings, stated that Gulf "reserves the right * * * to contest liability for the payment of taxes under the Joliet lease * * *" (Opinion, p. 5). Pursuant to that provision, Gulf, the lessee, refused to pay Joliet's federal income taxes. Gulf at all times made payments of the $7 dividends currently, but they were not received by Joliet's stockholders, since the government seized the dividend payments to satisfy Joliet's unpaid income taxes.[1] In 1949, in a suit brought by certain ones of the Petitioners, the District Court held Gulf obligated, under the lease, to pay the Joliet income taxes in addition to the dividends, and in February, 1950, while an appeal was pending, Petitioners sold all their Joliet stock.

After reviewing the circumstances concerning the alleged stoppage of dividend payments, the Court of Appeals stated:

---

1. The footnote on page 5 of the Petition says that "The opinion below states: 'for some reason not discernible * * * dividend payments were stopped.'" This is misleading, the quotation having been constructed by Petitioners by combining parts of two separate sentences (Opinion, p. 5).

"The purchase price of $240.00 per share included all rental payments which had been withheld by Gulf. The special master and the court below reviewed the facts in this connection and concluded that 'those matters are not relevant to the issue in the present case as they had no effect upon plaintiffs' judgment when plaintiffs sold their Joliet stock in February, 1950, and plaintiffs were fully informed as to such matters before they sold their stock.' With this conclusion we agree." (Opinion, pp. 5-6)

The rule of law by which the conduct of Gulf in purchasing plaintiffs' minority shares of Joliet was tested and approved in this proceeding was the most exacting of all possible rules that have been suggested for application against a majority stockholder in connection with a purchase of minority shares. The opinion of the Court of Appeals states:

"The real issue in the case arises from the alleged failure of Gulf to adequately inform plaintiffs of material facts which plaintiffs contend, if known by them, would have greatly enhanced the selling price of their shares. As to the duty of Gulf, the master found:

'As the defendant in February 1950 was the owner of substantially more than a majority of Joliet stock, there was a fiduciary relationship between defendant and the plaintiffs, minority stockholders of Joliet.

'This fiduciary duty required defendant in negotiating for the purchase of plaintiffs' Joliet stock to make complete disclosure of all material facts affecting the value of such stock before purchasing it from them.'" (Opinion, p. 6)

Under this strict standard, the courts below carefully reviewed the evidence in detail and found the issues for

Gulf. The Court of Appeals unanimously affirmed the decree of the District Court, including the following:

> "129. The figure of $240 per share for Joliet stock arrived at as a result of the negotiations prior to February 10, 1950, was arrived at after fair, arm's-length bargaining; defendant concealed no material facts from the plaintiffs and plaintiffs were in the possession of all the facts relevant to a determination of the fair value of the stock." (A. 151-152, 163, 164)

Referring to the cases relied on by Petitioners, the Court of Appeals stated:

> "These cases furnish support only for the proposition that majority stockholders of a corporation occupy a fiduciary relationship toward minority stockholders and, when purchasing their shares, are under an obligation to divulge all material facts." (Opinion, p. 8)

The fact that the evidence here showed that all material facts were known to the sellers, whereas the evidence in other cases as to other transactions showed that material facts were concealed, does not create a conflict between the decisions. The facts of this case have been reviewed by the Master in Chancery, by the District Court and by the Court of Appeals, and all have agreed that there is no factual basis for Petitioners' claim. No conflict with other decisions exists nor are there any important federal questions involved. While we will describe the facts in more detail below, it is not the office of the writ of certiorari to afford an additional review of the evidence as to the facts in a particular private controversy, and this salutary rule is especially appropriate where the Master in Chancery, the District Court and the Court of Appeals have all ar-

rived at the same conclusion after reviewing the evidence.[1]

Petitioners' claim as to allegedly undisclosed facts concerns a sale from Gulf to the government in September, 1951, of certain real estate in Chicago known as the Harrison Street property, to be used for post office facilities.[2] This was a year and a half after Petitioners had sold their Joliet stock, and more than a year after the Joliet lease had been terminated and Joliet had been dissolved. A portion of that real estate had formerly been included under the Joliet lease, but most of it had never had any connection with Joliet and, instead, had been owned outright by Gulf and its predecessor, Alton (Opinion, p. 6). The property was sold at a loss, the price received by Gulf being far below the book value of the property (SA. 338). By reason of the perpetual lease of all Joliet property, the courts below found, and Petitioners' principal witness conceded, that Joliet's stockholders would have received no part of the proceeds of sale even if the sale had been made before Joliet's dissolution and before Petitioners sold their Joliet stock (Opinion, pp. 11-12).

Petitioners erroneously assert that the sale was made at a profit and that in February, 1950, when they sold their Joliet stock, the sale was "approaching consummation" (Pet. 22); that "Gulf could have accepted the Government's lowest offer at any time and still made almost as

1. The present suit is the second one in which fraud has been charged in connection with acquisition of stock of leased lines in the Alton system. The first one, in which the plaintiffs were represented by the same counsel who represents Petitioners, concerned acquisition by Gulf of stock in another leased line. Like this case, it terminated in a decision that there was "no factual basis" for the charge. *Slater* v. *G. M. & O.*, 307 N.Y. 419, 121 N.E. 2d 398 (1954).

2. The 37 mile line of Joliet, between Chicago and Joliet, Illinois, has continued in operation as part of the Gulf railroad system.

huge a net profit" (Pet. 23); that "Gulf knew at all times that it could make a highly profitable sale to the Government" (Pet. 27); and that "We have seen that January [1950] was the month when a very quick closing was expected" (Pet. 41). The facts of record contradict these extravagant assertions. The evidence showed that the real estate in question was not sold at a profit but, instead, was sold for substantially *less* than the value at which it had been carried on the books of these railroads (SA. 338). The record also shows that at the time when Petitioners sold their Joliet stock, the government had made no offer for this real estate. It shows, instead, that the government was actively examining other sites for the possible purchase and that the government continued its active search for and review of various possible sites both before and long after February, 1950, without any determination as to which one would eventually be selected.[1] The Court of Appeals reviewed the evidence and stated, in part, as follows:

---

1. Petitioners refer to the contents of an internal report by Post Office officials in December, 1949, indicating favorable consideration of the Gulf site (Pet. 10, 45, 46) without mentioning that the evidence showed unequivocally that Gulf had no knowledge of the report until Petitioners obtained it from government files for the purposes of this case. (Findings 91, 92, A. 140) Moreover, in the language of the Public Buildings Administration Report of January 31, 1950, "no determination had been made as to any property • • •" and "A search for other locations further south, both on the east and the west side of the river is being continued" (SA. 314-315). In March and April, 1950, the government was reviewing eight possible sites (SA. 316-321, 335, 336) and was giving particular attention to a Soo Line site (SA. 316-318). In the language of the government report of May 29, 1950, the studies of the various possible sites were "still in the preliminary state" (SA. 323). In June, 1950, the government was "looking at several different sites as possible locations for post office facilities" (testimony of Hon. W. E. Reynolds, Commissioner, Public Buildings Service [formerly called Public Building Administration] of General Services Administration, SA. 68).

Petitioners' theory of the facts is contrary to the express testimony of the witnesses (including former Commissioner Reynolds of General Services Administration), contrary to the exhibits from government files referred to in Finding 112, quoted above, and contrary to the factual determinations made by the master, the District Court and the Court of Appeals. It is apparent from the evidence that, at the time when Petitioners sold their Joliet stock, neither Gulf nor anyone else knew that the government would eventually conclude its search for sites by selecting the Gulf property nor could anyone have known at that time what price would be paid for the property if the government selected it.[1]

The Petition contains numerous statements which are unsupported either by the findings of the courts below or by the evidence. Many of these statements result from attributing knowledge to Gulf, in early February, 1950, of all the events that did not happen until the late fall of 1950 and 1951. For example, the Petition states at page 27 that "Gulf knew on February 10, 1950 that by acquiring all Joliet's stock and dissolving Joliet before consummating the sale, it would acquire a tax-loss of about two and a half million dollars, which would be realized as soon as it completed the sale." Neither at this page nor elsewhere in the Petition is there a reference to the record to support that allegation. There is not a shred of evidence to that effect, and, instead, the evidence and the findings of fact were to

1. Gulf first offered the property to the government on April 11, 1950, at a price corresponding to an appraisal which it had received after Petitioners had sold their Joliet stock (SA. 21, 256, 261). That offering price was at about the book value. In October, 1950, when the government first determined to acquire this property, the government and Gulf were far apart as to price and the ultimate price was not arrived at until 1951, after further appraisal had been made (SA. 29, 30, 284-286).

"Although the evidence is not free from conflict, we are convinced that it furnishes ample support for the findings made by the special master, relevant portions of which are:

'92. Prior to February 10, 1950, GM&O had no knowledge or information that the government was giving Harrison Street property consideration more favorable than it was giving other Chicago sites proposed for acquisition by the government.

'97. Subsequent to February 10, 1950, and the acquisition by GM&O of plaintiffs' Joliet stock, GM&O continued its negotiations with the U.S. government authorities in its effort to sell the Harrison Street properties to the government. The negotiations continued with no definite commitment made by the government until October 5, 1950 when the government informed GM&O that it intended to acquire the Harrison Street property and would acquire it by condemnation if negotiation did not result in an agreement on the price to be paid.

* * * * *

'112. The correspondence between government officials contained in Defendant's Exhibit D-32 indicates that as of April, 1950, they still had not come to any decision to purchase the Harrison Street property and that they were giving serious consideration to seven other sites in Chicago as suitable for purchase for Post Office use; that as late as June 7, 1950, they were giving consideration to sites offered by the Santa Fe Railroad and by a Mr. Tucker.

'115. Sale of the Harrison Street properties to the government was not assured until October 5, 1950, when the government representatives informed GM&O that the government had decided to acquire the property, either by negotiation or condemnation.'" (Opinion, p. 7)

the contrary. On February 10, 1950, when Petitioners' offer to sell their Joliet stock was accepted, neither Gulf nor the government knew or could have known that the government, in the fall of 1950, would select the Harrison Street property as the site for the post office facilities. Moreover, the appraisal of the property had not yet been received. When it was received and used as the basis of the offer made by Gulf to the government in April, 1950, the amount was far above the eventual price agreed upon in 1951 (SA. 30, 256, 261, 338). The testimony of Mr. F. M. Hicks, the Executive Vice President of Gulf, was that "*We didn't know of it at the time* but as developments proved later on, we were able to take a loss for income tax purposes because we sold the property at less than its cost. Naturally we took an income tax deduction but that did not come along until 1951" (Hicks Deposition, p. 160).[1] Moreover, the tax deduction merely reduced the loss to Gulf; if the price for the property had turned out to be about the recorded cost, there would have been no tax deduction, and yet Gulf would have received more money for the property.

Similarly, Petitioners' claim that the dissolution of Joliet was motivated by an effort to obtain a tax deduction is contrary to the evidence. As early as 1947 Gulf had publicly announced its intention to bring about this dissolution. Gulf's 1947 application to the Interstate Commerce Commission stated that it intended to acquire all the stock of Joliet (and of another leased line) and, upon such acquisition, to cancel the leases and dissolve those corporations (SA. 295-297). The desirability of eliminating the multiple corporations had been suggested by Judge Barnes in his opinion approving the reorganization plan of the Alton (SA. 347). The Commission's decision in 1947 stated that "If the ultimate object of acquiring all the stock is attained,

1. Emphasis supplied in all quotations in this brief.

the applicant [Gulf] will be able to terminate the leases and dissolve the corporations with a resulting simplification of its corporate structure" (SA. 345). The determinations of the courts below as to the purposes of Gulf and of its lack of knowledge of the facts which Petitioners would attribute to it are firmly grounded upon the evidence. Most of those alleged facts, indeed, were completely nonexistent.

Prior to Petitioners' sale of their Joliet stock, representatives of Petitioners and representatives of Gulf independently estimated the maximum price per share that Gulf could afford to pay for that stock, and the results of the calculations were substantially identical. Mr. Harold Gardner, who is a lawyer skilled in the matter of purchases and sales of leased line securities, represented most of the Petitioners in the sale of their Joliet stock (SA. 118 *et seq.*). He was the one who set the offering price at $240, consisting of $225 plus the accrued dividends of $14 and plus a $1 fee to the broker. In so doing, he testified that he had calculated that the value to Gulf of eliminating the Joliet was $260-plus, per share (SA. 176). Gulf's representatives came to the same conclusion independently, calculating that the maximum Gulf could afford to pay was $244 plus the $14 accrued dividends (SA. 52-53). Thus Petitioners' calculations were substantially identical with those of Gulf, further confirming the findings of the courts below that Petitioners were in possession of all the material facts.

## ARGUMENT

Petitioners' statement of the questions presented (Pet. 14-15) involves several erroneous assumptions of fact. The essential question on this petition for writ of certiorari may be stated as follows: "Where no misrepresentation was charged, and where both courts below have found (a) that Gulf concealed no material facts, and (b) that Petitioners were in possession of all material facts when they sold their Joliet stock and on the basis of these findings; (c) that Gulf did not violate the S.E.C. Regulations, should this Court review the detailed evidence upon which those determinations were made?"

### I. The Decision in this Case Is Not in Conflict with the Decisions Cited by Petitioners.

(a) *La Buy* v. *Howes Leather Co.*, 352 U.S. 249.

In *La Buy*, both parties objected to the entry of an order which referred a matter to a special master and both parties moved to vacate that order. Having made its position clear, one of the parties obtained from the Court of Appeals for the Seventh Circuit a writ of mandamus ordering the District Court to hear the case without a master. This Court affirmed.

As that same Court of Appeals held in this case, the facts here are quite different. The Court of Appeals stated:

> "The court of its own volition referred the case to a special master. Plaintiffs argue that the reference was improper and that the entire cost of the reference should be borne by defendant. There may be a question as to whether this was a proper case for reference, but on the record we cannot hold that the action of the court was erroneous. Plaintiffs state that in open court on more than one occasion they objected to the

reference. This appears to be an overstatement because at no point did they object. The most that can be said is that counsel indicated a preference for a court trial, although conceding that it might properly be referred on the issue of damages. No question is raised but that the fees which the court fixed for the special master are reasonable. Under the circumstances, we would not be justified in altering or modifying the decree as it relates to costs." (Opinion, pp. 13-14)

While Petitioners indicated, at most, a preference for a court trial, they did not object, and did absolutely nothing to apprise the court or Gulf that they were challenging or might later challenge the reference. Instead, Petitioners merely asked the District Court for the name of the master and then, after the Court named the master (A. 173), Petitioners proceeded to submit their evidence and brief to the master, showing their complete acquiescence in that procedure. It would be harmful to the administration of justice and unfair to the other party if a litigant, having so acquiesced and proceeded before the master, were thereafter to be permitted to challenge the order of reference by retroactive objection after rendition of a master's report unfavorable to him. The decision of the Court of Appeals in the *La Buy* case was issued on October 13, 1955, and the decision of this Court, affirming that ruling, was issued on January 14, 1957, substantially before the date (March 6, 1957) when the District Court referred this case to a master, yet Petitioners elected to make no objection, motion to vacate or application for mandamus. Thus, even if the District Court had exceeded the limits of its discretion in referring this matter to a master (which is not conceded), Petitioners' belated objection to the reference provides no basis for an attack upon the judgment. The decision is wholly consistent with *La Buy*.

One other point is noteworthy in this connection. In the Court of Appeals Petitioners did not ask to have the judgment reversed an account of the reference. Instead, what they there sought was to have that court shift the costs of the reference to Gulf, which had prevailed on the merits. The Summary of Argument in their brief stated, as to this point:

> "This case should not have been referred to a Master; having been so referred on the basis of defendant's erroneous representations as to the length of trial, the entire cost of the reference should be charged to it."

The District Court had indicated from the outset that it thought the case was a proper one for reference (A. 170). Subsequently, during a discussion as to setting the case for trial, counsel for Gulf estimated that the trial would take a week, and that the preparatory work which still remained "will have the effect of actually holding down the amount of time that will be necessary for the presentation of the case itself" (A. 172). While the oral hearing before the master took only two days, comprising 287 pages of transcript, depositions were introduced at the hearing without being read, containing 517 pages of transcript, together with 74 exhibits of 566 pages (Sum. 2, A. 5). Had the depositions been read in court, conformable to the usual practice, the time consumed would have been at least three to four days more. The depositions were received in evidence by agreement of the parties, the Special Master having stated that he had read them and was familiar with them. Clearly a court hearing with depositions, oral hearing, exhibits, pleadings and briefs aggregating 1639 pages (Sum. 2, A. 5) would have taken more than a week, without allowance for other court matters that necessarily occupy part of the court time.

(b) *Speed* v. *Transamerica Corp.*, 235 F. 2d 369.

The rule of law under which the Court of Appeals for the Third Circuit proceeded in the *Speed* case was exactly the same as the one on which this case was decided. The Petition, at page 21, quotes from the *Speed* opinion as follows:

> "The rule is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers."

The opinion in the present case stated and gave effect to the same rule (Opinion, pp. 6, 8). The Court of Appeals pointed out, however, that the factual situation here was sharply different from the facts in the *Speed* case (Opinion, pp. 9, 13).

As the Court noted, in *Speed* there had been a huge increase in value of the readily salable tobacco inventory before the minority stock was purchased. The information as to that increase over the book value, together with the intention of the majority stockholder to obtain that increase by liquidating the corporation, was a material fact which was not divulged to the sellers. Here, in contrast, there was no increase at all over the book values and, when the eventual sale took place of the portions of the Harrison Street property that had formerly been under the Joliet lease, the price was substantially less than the book value.

Moreover, the Court of Appeals pointed out that the circumstances here regarding the effects of the perpetual lease

as limiting the Joliet stockholders to a $7 per year payment in perpetuity were not at all present in *Speed* (Opinion, p. 13). The Court noted that if the *Speed* plaintiffs had not sold their stock, "as full equity owners of the property they would have been entitled to share in the proceeds of the sale or in the reinvestment thereof. In contrast, plaintiffs as shareholders in Joliet had no right to share in the proceeds of the sale by Gulf to the government or in any income derived from the investment of such proceeds" (Opinion, p. 13).

In the lack of any increase of values over the book values, lack of any assured sale of any part of the property involved, and the lease limitations upon the rights of the stockholders, the facts here were totally different from those in the *Speed* case. In both cases the same rule of law was applied to test the conduct of the majority stockholder and the difference in result was due solely to the sharp difference in facts.

In discussing the *Speed* case, Petitioners make several statements as to supposed facts and factual inferences in this case (Pet. 22, 23) which, as we have pointed out in the Statement of the Case, bear no resemblance either to the factual determinations of the lower courts or to the evidence. This is not even a matter where the evidence might have permitted the trial court to make the factual determinations sought by Petitioners. Here the evidence directly negatived Petitioners' theory of the facts. It is simply not true that in February, 1950, when Petitioners sold their stock, the sale of the Harrison Street property was "approaching consummation" or that the sale, when made in 1951, was at a profit, or that the government had made an offer for the property or that Gulf knew that the sale would be made at a deductible loss, or that it would be made at all or that the sale could not have been made with-

out the consent of each Joliet stockholder. Petitioners' extreme statements serve only to emphasize the soundness of the decision of the Court of Appeals that, on the facts of this case, the decision of the District Court was in no way in conflict with the *Speed* case.

(c) *Western Pacific R.R. Corp.* v. *Western Pacific R.R. Co.*, 206 F.2d 495

The Western Pacific case involved a known tax loss of one subsidiary corporation which was used in a consolidated corporate tax return as a deduction against system revenue. The decision denied a claim by a stockholder of the subsidiary corporation that the parent corporation was liable to pay something to the subsidiary for having so filed the consolidated return. There is neither a resemblance between the facts of that case and the facts here, nor any conflict in the decisions.

The portion of the Petition which discusses that decision is replete with erroneous statements as to the facts of this case. For example, evidently in an effort to show that there was a known tax loss (called by Petitioners a "hidden tax windfall") at the time when Petitioners sold their stock, they say that "Gulf knew on February 10, 1950 that by acquiring all Joliet's stock and dissolving Joliet before consummating the sale, it would acquire a tax loss of about two and a half million dollars, which would be realized as soon as it completed the sale" (Pet. 27). As we have pointed out in the Statement of Facts, pages 11-13, *supra*, both the findings of fact and the evidence were directly to the contrary.

No one knew at that time that there would ever be a tax deduction at all. The government had not decided to select this site and, instead, was actively looking for other sites;

the appraisal being made for Gulf had not yet been received, and, when it was received, was for an amount about two millon dollars more than the ultimate price. The tax loss arose through the government's decision to select this site, a decision which was not made until October, 1950, followed by reappraisals by both the government and Gulf and negotiations which eventually led, in 1951, to the sale at a reduced price which created the deductible loss. The master's report summarizes the testimony in this respect as follows: "At the time GM&O was acquiring the stock, GM&O did not know that GM&O would be able to take the loss for income tax purpo s that was actually taken after the sale in 1951" (Sum. 212, A. 75). There is no evidence to the contrary.

Moreover, the deductibility for income tax purposes merely reduced the extent of the loss on the sale. Had Gulf been successful in its effort to sell the Harrison Street property for its book value, there would have been no tax loss and yet the net amount received by Gulf for the property would have been more than the net amount, after taxes, that was actually received. The courts below properly rejected Petitioners' effort to have them infer, contrary to the evidence, that Gulf acquired the remaining Joliet shares and dissolved Joliet for the purpose of creating or obtaining a tax loss.

(d) *Dunnett* v. *Arn*, 71 F. 2d 912; *Hughes* v. *Securities and Exchange Commission*, 139 F. 2d 434; *Norris & Hirshberg, Inc.* v. *Securities & Exchange Commission*, 177 F. 2d 228

Petitioners' citation of these cases is based upon their incorrect statement that "The court below evidently assumed that the fiduciary standard required of Gulf here was fixed by the law of Illinois * * *" (Pet. 28).

The reason for the discussion of the Illinois cases by the Court of Appeals was that, of the two counts in the complaint, one was predicated on diversity of citizenship and charged fraud based on the common law of Illinois. The other charged a violation of Rule X-10B-5 of the S.E.C., under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. 78j(b). In their brief to the Court of Appeals, Petitioners stated: "It is not believed that there is any substantial difference between present Illinois law and Federal law on this subject * * *" (p. 21).

The decision below considered both counts of the complaint, discussed both the Illinois cases and the federal cases (including the cases involving Rule X-10B-5) and held that Gulf had violated neither its common law obligation nor the obligation created by Rule X-10B-5. There was no holding that Illinois law superseded federal law or that the federal law would not be given "paramount effect." Instead, there was an express holding (quoted at page 2, *supra*) that Gulf had not violated that federal rule and a holding that Petitioners "are not entitled to recover under" either of the two causes of action stated in the complaint (A. 153, 163, 164). These determinations were based upon the finding that "defendant concealed no material facts from the plaintiffs and plaintiffs were in the possession of all the facts relevant to a determination of the fair value of the stock" (A. 151-152, 163, 164).

(e) *Alton Plan of Reorganization*

The Court of Appeals pointed out that, unlike stockholders in an ordinary company, the stockholders here lacked all proprietary interest in Joliet "by reason of the fact that by the lease all of Joliet's property was demised in perpetuity" (Opinion, p. 10). In the course of its discussion on this point, the Court approved the finding and

conclusion that the $7 dividend payable on Joliet stock would "not be affected in any way as a result of a sale or other disposal of Joliet's interest in the Harrison Street properties" and that "Joliet stockholders, in the event of a sale of part of Joliet's property during the term of the lease, would derive no benefit from such a sale, even though made at a great profit, because their dividend was limited to $7 per share" (Opinion, p. 11). After noting that the testimony of both parties was to this effect, the Court concluded that the situation of shareholders of Joliet was in marked contrast to shareholders in the ordinary case (Opinion, p. 12).

In the course of this discussion the Court referred to the fact that the lease in perpetuity had previously been referred to, both by the Court of Appeals and by the Supreme Court of Illinois, as having vested title in Gulf. The Court then referred to a provision in the lease assumption agreement of 1947 that the lease should be deemed a lease and not a conveyance in fee. This is the provision of the Alton Plan of Reorganization which, say Petitioners, conflicts with the decision. However, after saying that it is not discernible how that provision altered the situation, the Court of Appeals said:

> "*In any event,* Joliet stockholders still were entitled to receive $7.00 per share annually and nothing more." (Opinion, p. 11)

Thus, as the Court of Appeals indicated, it made no difference for the purposes of this case whether the lease be deemed a perpetual lease or a fee. In either event, the rights of the Joliet stockholders, unlike the rights of stock-

holders in the ordinary company, were limited to the receipt of $7 per year.[1]

That the Court of Appeals was not resting its decision on the principle that the lease conveyed a fee is further shown by the fact that the opinion went on to consider the effect of "the remote possibility that the leasehold property might revert to Joliet" and to consider, in that connection, various decisions as to reversions after long-term leases (Opinion, p. 12).

Plainly, the decision in no way conflicts with the Alton Plan of Reorganization.

## II. The Decision Does Not "Conflict with the Unmistakable Trend of the Decisions of All the Federal Courts in This Century."

Under the comprehensive claim quoted in the caption above, Petitioners express at length their disagreement with the findings of fact below and with much of the testimony and exhibits on which the findings were based (Pet. 32-50). Petitioners accuse the Court of Appeals of "unusual blindness" (Pet. 32); charge the master and the court below with "clear error" in the findings of fact (Pet. 47); and say that the courts were "naive" in accepting the master's finding as to certain facts (Pet. 50).

---

1. In an opinion by Judge Swan, for a three-judge District Court, in a case concerning the fair value of leased line stocks where the leases were for long terms, the court said: "We agree with the [Interstate Commerce] Commission's statement that 'For all practical purposes, the stocks of the leased lines have a value to their owners measurable solely by the fixed rental payable under the leases and the dividends payable therefrom on the stocks.'" This Court affirmed that decision, *per curiam*, on March 30, 1959. *Friedman* v. *United States*, 168 F. Supp. 815, 339 U.S. 205.

A Master in Chancery, a District Court judge and three judges of the Court of Appeals have unanimously agreed that there is no factual basis for Petitioners' charges. Petitioners' theory would call for a conclusion, completely without support, that several of the witnesses committed perjury. We cannot set out the pertinent evidence and findings in detail in this brief, but the master's report, by summary of the evidence, shows that the record fully supports the findings below (A. 30-153). This Court has long held that it will not issue a writ of certiorari to provide a further review of the factual issues of a particular case, especially where both the District Court and the Court of Appeals have arrived at the same conclusion.

As to Petitioners' argument about the effect on them of Gulf's contest of liability (as lessee) to pay Joliet's income taxes, and the resulting accruals of dividends on Joliet stock, the opinion shows that the Court of Appeals fully reviewed the circumstances. The Court discussed the point for almost all of page 5 and part of page 6 of the opinion, and concluded by approving the conclusion below that those matters "had no effect upon plaintiffs' judgment when plaintiffs sold their Joliet stock in February, 1950, and plaintiffs were fully informed as to such matters before they sold their stock."

Gulf's right to contest liability for those taxes had been expressly stated as a provision both of the Alton reorganization plan and of the lease assumption agreement approved by the I.C.C. and by the District Court and executed in 1947. In the tax litigation the District Court in 1949 held that Gulf was obligated to pay those taxes, but there was no holding, as Petitioners seem to claim, that Gulf

somehow had lost the right to contest that liability. The evidence shows that the purchase price which Petitioners demanded and received for their stock in February, 1950 ($240) included all dividends ($14) which had accrued during that contest. It also shows that the price had not been depressed by the existence of the tax controversy. In the summer of 1947, "The Joliet stock was selling on the New York stock exchange at a bid price of approximately $125 a share" (Sum. 132, A. 54). On August 25, 1947, Gulf applied to the Interstate Commerce Commission for authority to acquire Joliet shares for the purpose of terminating the lease and stated its position that it was not obligated to pay the Joliet income taxes (Sum. 127-130, A. 52-54). All but two of the Petitioners bought their Joliet stock in the period from September, 1947, to January, 1949, their purchases being at prices between $145 and $159 per share (SA. 331-333). Their sale price of $240 in February, 1950, gave them a large profit. Among the findings were the following:

> "44. The assumption agreement specifically reserved GM&O's right to litigate the question of its liability for payment of Joliet's income taxes, and GM&O made no agreement in 1945 or subsequently, to pay such taxes until such time as it was judicially determined to be liable therefor under the lease.
>
> "45. The plaintiffs contended that GM&O's refusal to pay Joliet's 1946 income tax, and its making public that decision in December, 1947, was intended to discourage Joliet stockholders from continuing to hold their stock, to encourage them to accept GM&O's exchange offer and to depress the market value of Joliet stock.
>
> "46. Whether such was GM&O's intention is irrelevant since the facts show that no such consequences resulted from defendant's conduct." (A. 128)

At page 39 the Petition says that "Gulf's frantic haste in making the Joliet stock purchases proves that it was an emergency matter," and elsewhere the Petition also refers to the same claim of "extraordinary emergency action" (Pet. 42). The record shows that there was no haste at all with the sole exception of the fact that Petitioners themselves, when they offered their shares for sale, set a five-day time limit, and their offer was accepted within the short period which *they* had fixed (A. 57, SA. 114-116). An offer was then made for the purchase of the shares of the remaining Joliet shareholders and, within the next two months, the others accepted.

Similarly, Petitioners say that "defendant's 'long-range plan' for Joliet had been to starve the minority into submission by an indefinite suspension of dividend payments" (Pet. 39). There is not a word of evidence to support such an allegation; this appears to be merely Petitioners' way of saying that Gulf, pursuant to the Alton plan of reorganization and the lease assumption agreement, contested liability for Joliet's income taxes.

A characteristic of Petitioners' discussion, illustrating the nature of their attack upon the findings of fact, is their repeated statement that some supposed circumstance "must have been" the fact. Thus Gulf "must have been apprised" of certain considerations (Pet. 41), neither of which was developed in the evidence. Mr. Hicks "must have felt quite hopeful" and his hopes "must have risen far higher" (Pet. 45). Certain considerations as to title to a portion of the Harrison Street property "must have occurred to some one," and a talk "must have taken place" before a certain time (Pet. 49). A decision of this Court relating to capital gains tax on a taxable gain of corporate property "must surely have caught their attention" as to

a tax loss (Pet. 49), although no tax loss occurred until a year later. Such suppositions do not take the place of evidence and the evidence was contrary to the suppositions.

Others of Petitioners' statements, some of which were noted in our Statement of Facts at pages 8, 9, 11 and 12, *supra*, are in the form of flat statements of fact as if the evidence and findings had been to that effect, although the statements merely represent Petitioners' attack on the findings.

Petitioners' inference that Mr. Hodes found out from the Postmaster General or some other government official the contents of an internal Post Office report of December, 1949, favoring the Harrison Street site is contrary to the testimony of Mr. Hodes (Sum. 309, A. 113) and contrary to the findings of fact (Finding 91, A. 140). The statement that in January, 1950, "a very quick closing was expected" (Pet. 41) also is contrary to the evidence and findings of fact (Finding 92, A. 140). The statement that "When Gulf first dealt with the Post Office Department, it described the whole property as its own" (Pet. 48) is in sharp contrast to the evidence, which was that "At that time [December 1, 1949], GM&O told the Post Office representatives that certain of the properties were owned by Joliet and certain of the properties were owned by GM&O, but they raised no question as to what kind of title GM&O would give" (Sum. 178, A. 66). The statement that in lat January, 1950, "Gulf determined that the closing must be deferred till 1951" (Pet. 44) and the allegations that the purpose of Gulf's acquisition of Joliet stock and dissolution of Joliet was to obtain a clear title to part of the Harrison Street property and to obtain a "potential tax bonanza" (Pet. 49) are similarly contrary to the evidence and findings of fact (Findings 91, 92, 93, 97, 105, 106; A. 140, 142, 144). The various assertions and suppositions

of petitioners were all reviewed by the courts below and, in the light of the evidence, were properly rejected.

## CONCLUSION

The decision conflicts with none of the decisions referred to in the Petition and involves no important question of federal law. Petitioners' contentions resolve themselves into objections to the findings of fact in this particular case, and, both courts below being in agreement, the petition for writ of certiorari should be denied.

KENNETH F. BURGESS
D. ROBERT THOMAS
WALTER J. CUMMINGS, JR.
ARTHUR R. SEDER, JR.

*Attorneys for Respondent*

11 South La Salle Street
Chicago 3, Illinois

SIDLEY, AUSTIN, BURGESS & SMITH
11 South La Salle Street
Chicago 3, Illinois

*Of Counsel.*

FILE COPY

Supreme Court, U.S.
FILED
JAMES R. BROWNING, Clerk

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1958**

**No. [redacted] 102**

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

v.

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

## REPLY BRIEF FOR PETITIONERS IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

WATSON WASHBURN
*Attorney for Petitioners*
36 West 44th Street
New York 36, N. Y.

WASHBURN & GRAY
36 West 44th Street
New York 36, New York
*Of Counsel*

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1958**

**No. 986**

---

THE JAMES BLACKSTONE MEMORIAL LIBRARY ASSOCIATION, *et al.*,

*Petitioners,*

v.

GULF, MOBILE AND OHIO RAILROAD COMPANY,

*Respondent.*

---

## REPLY BRIEF FOR PETITIONERS IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

Respondent's brief requires only a short reply.

Respondent makes no defense of the extraordinary statement of the Court of Appeals that plaintiffs had abandoned the claim of damage from continued stoppage of Joliet dividends, when merely that part of their argument below on this point quoted in their petition herein (pp. 32-37) covers over five pages. Gulf merely asserts that the Court of Appeals "discussed the point" (after its supposed abandonment), but actually it did not do so.

Gulf states (p. 25) that "the price had not been depressed by the existence of the tax controversy," (meaning, we presume, the improper stoppage of divi-

dends). Such an assertion is contrary to all experience, and illustrates Gulf's constant efforts to escape from the facts.

Gulf many times (pp. 8, 9, 11, 12, 17, 18, 20) reiterates the absurd contention that because the former Joliet property was sold for less than book value (which was based on cost thirty or more years before Gulf acquired its interest in 1947), the sale was unprofitable to Gulf. On the contrary, the fact was that the high book value (and consequent high tax cost) of the Joliet realty was one of the important elements of value of the minority stock, for the only way in which Gulf could take advantage of this high cost, thus making a large tax saving through a pure technicality, when in fact it was getting four million dollars more (tax-free) from the Government than it could from any one else, was by dissolving the Joliet before consummating the sale. And it is plaintiffs' irrefutable statements regarding this tax windfall that Gulf principally objects to as unjustified.

Gulf correctly states (p. 13) that Mr. Gardner calculated the maximum value to Gulf of Joliet stock as $260.-plus. But far from proving that he was "in possession of all the material facts," this proves just the reverse. Obviously, Mr. Gardner did not know that Gulf had decided it could afford to pay $259. a share, or he would have asked at least for that price. And, what was much more important, he knew nothing whatever of the pending Post Office sale, or the hidden tax windfall.

Gulf states (p. 24) that "A Master in Chancery, a District Court Judge and three judges of the Court

of Appeals have unanimously agreed that there is no factual basis for Petitioner's charges." In fact, the Master and the District Court found that there was no conflict in the evidence (except as to the fair value of Joliet shares in 1950). The Court of Appeals found the evidence "not free from conflict," but concluded that "it furnishes ample support for the findings made by the special master," beginning with the finding that "Prior to February 10, 1950, GM & O had no knowledge or information that the government was giving Harrison Street property consideration more favorable" than other Chicago sites. The Court of Appeals thus did not agree with the finding below of no conflict, but though the findings below depended solely on undisputed facts, documents and depositions, the Court of Appeals did not review these independently, as we submit it should have, but instead was satisfied with supposed "ample support" for the findings below,—a criterion not properly applicable here.

Even on the basis of this erroneous criterion, it seems that the Court below should have found the District Court's decision clearly erroneous. And if it had undertaken an independent review, it could not conceivably have reached the conclusion quoted in the preceding paragraph, in the face of the following undisputed circumstances: the sudden decision to abandon the elaborate appeal then about to be argued on the tax question; the simultaneous dispatch of an important executive from Mobile to New York to buy plaintiffs' stock in apparent violation of the I. C. C. order; the otherwise unexplained pause in the Government negotiations until the last share of Joliet was bought; the frantic haste to dissolve Joliet (the I. C. C.

application alleging total stock acquisition being actually executed three days before the fact); and finally the completely damning admission in Gulf's own directors' minutes that Gulf had hoped to consummate the proposed sale to the Government by June, 1950, but now was authorizing temporary financing till June, 1951.

In its briefs below, Gulf offered a series of explanations, which grew more fantastic with each attempt, of the crystal-clear minutes. Before this Court, it has given up the task. Though the burden of explanation was of course on Gulf as the fiduciary, it offered no evidence whatever on this subject.

In footnote 1, page 8, Gulf impliedly criticizes the conduct of plaintiffs' counsel in an entirely different litigation. Since Gulf introduced this extraneous matter, we call this Court's attention to the dissenting opinion of Presiding Justice Peck and Justice Callahan in *Slater* v. *Gulf, et al.*, 279 A. D. 166, 172, stating that "the letter of May 25, 1956, appears on its face to be a contract, at least binding the Defendants to a good faith effort to carry it out." Gulf escaped liability there by a tricky technicality, and the fact that it refers to that case with apparent pride is a good indication of its ethical standards.

In a footnote to page 5, Gulf charges that it is misleading to quote the opinion below as stating that "for some reason not discernible * * * dividend payments were stopped," and denies (p. 26) that there is any evidence that Gulf's " 'long-range plan' for Joliet had been to starve the minority into submission by an indefinite suspension of dividend payments." On the contrary, plaintiffs' statements are supported

by Judge Igoe's findings, approved by the Master, quoted at pages 7 and 8 of their Petition. And if as the Master found "the possibility of" Judge Igoe's decision's "being set aside on appeal was practically non-existent" (111, A. 146), it was improper for Gulf to continue the litigation. On the other hand, if Gulf's appeal had any chance of success, the sudden decision to abandon it in February, 1950, after spending so much effort to perfect it, emphasizes Gulf's urgent need then to acquire 100% Joliet stock ownership at all costs, in view of the pending Government deal.

Gulf attempts (p. 21) to explain away the Court of Appeals' evident reliance on Illinois law by quoting the opening words of a paragraph in petitioners' brief below, which in the interests of accuracy we quote in full, italicizing the omitted portion: "It is not believed that there is any substantial difference between present Illinois law and Federal law on this subject, *but as the plaintiffs are suing under both, and are entitled to any additional benefits conferred by Federal Law, and as the Federal decisions, covering the entire country since the enactment of the relevant statutes beginning in 1933, are naturally much more numerous, we limit our citations largely to Federal decisions. As the Third Circuit Court of Appeals said in Zahn* v. *Transamerica Corp.*, 162 F. 2d 36, 44: '*The trend of the Federal decisions is unmistakable.*'"

There was no apparent purpose for the Court of Appeals to analyze so carefully the old Illinois decisions as to "assured sale," unless it believed that Illinois law governed the standard of duty owed by majority stockholders under the Federal statute. The Court of Appeals actually found (page 7 of its opin-

ion) that Gulf "was anxious" (as it had been for several years)[1], to sell the Harrison Street property, and that it had hopes, perhaps with some reason, of "consummating a sale to the government." This is only a pale reflection of the admission in Gulf's own minutes that it had hoped at some time before April 14, 1950 (beyond doubt before realizing the necessity of buying all Joliet's stock first) *to complete the sale before the summer*, and was still confident of completing it in the following year, as it did. But even so, we submit that under the Federal rule, such a reasonable hope of making such a remarkably profitable sale should have been disclosed by the fiduciary. Surely if a large oil company started drilling on the beneficiary's land, the duty of disclosure would exist even if there was no assurance of finding oil. But the Court of Appeals regarded its finding as of no help to plaintiffs, for as it went on to show (under an erroneous interpretation, we submit, of the Illinois law) only an "assured sale" need be revealed in Illinois. Of course, the Court of Appeals did not overlook plaintiffs' alternative claim under the Federal statute, but it construed the statute not as creating a new and nationwide standard of fiduciary obligations toward minorities, but merely as adopting the standard previously applied in each State, respectively.

Gulf also (p. 22) would treat as mere dicta the repeated statement in the opinion below that the Joliet lease was really a conveyance in fee, and hence Gulf finds no conflict with the Alton Plan of Reorganization, which specifically confirmed that the lease was not a conveyance. This is an extraordinary conten-

[1] The clause which we have bracketed was an obvious misconception, as Gulf evidently concedes. See our Petition, p. 37.

tion, since the Court of Appeals evidently regarded its view that the lease was a conveyance as a fundamental basis of its decision. The Court will observe, contrary to Gulf's present claim that there was really no difference between a lease and a conveyance, that since it was necessary to convey a fee title to the Government, a *lessor* would necessarily have to execute the deed, which a former grantor would not. Also, capital gain or loss would accrue to a *lessor*. And the stockholders of a *lessor*, whose consent was necessary to the sale of the fee, would naturally be entitled to bargain for a fair share of any profitable dealings with the fee.

The Court of Appeals evidently thought that the above incidents of a landlord's ownership under a lease would not attach to the Joliet, because it did not own its property any longer, and its stockholders had nothing but a contractual right to $7. a share annually. It was so impressed with this aspect of the case that it paid no attention to the analogous case of the *New York & Harlem R. R. Co.*, whose stockholders are limited to $5. a share annually, but whose stock has ranged in market value on the New York Stock Exchange from $300. to $600. per share. Of course, this is on the basis not of its yield, but of the value of its property. The New York & Harlem situation is part of the record in this case, unlike the leased lines referred to in Gulf's brief (footnote, p. 23; *Friedman* v. *United States*, 168 F. Supp. 815, 359 U. S. 205). There, the forced merger of the leased lines by the I. C. C. was upheld because the leases (unlike the Joliet's) gave no rights to the lessors' stockholders individuality. This confirms the "disability" that Mr. Hicks knew of, but did not dis-

close to the plaintiffs—that Joliet could not be dissolved without the unanimous consent of its stockholders. Furthermore, there was no evidence in that case of any special strategic value of any of the lessors' holdings, or of any tax advantage, and *a fortiori* no concealment of such elements of value by an acquisitive fiduciary.

We believe, on the basis of Gulf's own actions, the undisputed surrounding circumstances, the contemporary documents, and Gulf's admissions, that not only was the decision below clearly erroneous, and unjust to the numerous plaintiffs in this action, but also that the issues involved are of sufficient general interest and importance to justify the granting of the writ of certiorari applied for, for the reasons specified in the Petition.

Respectfully submitted,

WATSON WASHBURN
*Attorney for Petitioners*
36 West 44th Street
New York 36, N. Y.

WASHBURN & GRAY
*Of Counsel*